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%
August - 2013	-5.11%	-2.90%	-1.01%	-4.45%	-3.18%
September - 2013	3.37%	3.14%	5.06%	2.16%	6.38%
Year to Date	6.89%	19.81%	24.91%	15.46%	27.68%
Inception to Date	32.71%	73.17%	77.72%	55.77%	87.55%

* 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.

SEPTEMBER 2013 RESULTS

The Fund bounced back in September, after a pullback in the markets in August. September's 3.37% gain was the second highest monthly result of the year, and beat out two of the stock market indices (the S&P 500 and the Dow Jones). The NASDAQ and Russell 2000 were the table leaders for the period.

Year-to-date, the Fund is up 6.89%. As we discussed last month, we are doing very well in a difficult period for all credit investments since May. Of course, we trail the stock market indices, which are all having an extraordinary 2013, ranging from 15.46% to 27.68% increases. Tremendous, but sustainable?

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We reached a landmark this month: the Fund's fourth anniversary. Forty-eight months after our launch, the Fund is up +32.71%, after all fees and expenses. In absolute terms, that represents a very decent showing. However, we trail the stock market indices, which have been in a record bull run since 2009.

As we discuss in our four year look back at the twists and turns of the past 4 years, our returns were hobbled by the Euro-crisis in 2011. However, since modifying our investment strategy from January 1, 2012 on, the Fund's results have been outstanding. According to Partner's Admin, in the past 21 months, the Fund is up 29.36%. On an annualized basis that's 16.8% a year, twice our Inception To Date pace.

We are ahead of the Dow Jones index over this period, but trail the other three indices. (The top performer since 2012 is the small-cap oriented Russell 2000, up 48.5%). Given that the last few months have seen most leveraged debt investments post negative or flat returns, we are encouraged by our results over the medium term.

Month	BDC Fund II	S&P 500	NASDAQ Comp	Dow Jones	Russell 2000 DRI
Jan. 2012 to Date	29.36%	38.98%	44.79%	23.84%	48.54%

THE FUND'S FOURTH YEAR ANNIVERSARY

We have reached the Fund's fourth anniversary, and cannot resist the temptation, as with all anniversaries, to look back. The numbers generated by our independent administrator show that the Fund is up 32% in total, after all fees and expenses. However, the numbers do not tell the full story, so we're going to elaborate. Now that we can look back, we can see that the Fund has been in four distinct stages over these last 48 months. Just look at the monthly performance trends over the Fund's lifetime and you'll see what we mean.

THE FOUR PHASES

The first phase began with the launch of the Fund & lasted to the early spring of 2011. We call this the Recovery Phase. During that period the value of Leveraged Debt assets recovered in fits and starts from the impact of the Great Recession. Most assets that were trading at below book value recovered to close to full value. Many underperforming loans were sold, restructured or filed for bankruptcy. Distribution levels increased.

The second phase lasted between the spring of 2011 and the end of that year. Macro-economic and political factors intruded on the market: concerns about the impact of the Fukushima earthquake on the Japanese economy, the prospect of the dismantlement of the Euro-Zone and political logjam in Washington impacted all asset values, including Leveraged Debt. Notwithstanding that debt fundamentals continued to improve throughout 2011, there was a crisis of market confidence, with the VIX reaching levels not seen since the depths of the Great Recession. We call this the Market Meltdown phase.

The third phase began shortly before the 2012 New Year and lasted till early May 2013. Markets worries about Europe, Washington and Japan were put on hold. Virtually all asset classes returned to favor, including Leveraged Debt. Asset prices recovered to, and then exceeded, the levels achieved in the Recovery Phase. Loan fundamentals continued to improve and virtually all underperforming loans were purged from the system. Floods of new investor capital from multiple sources reentered the market. We call this the Rebound Phase.

The fourth phase (in which we remain) began in May 2013 when the Fed taper talk and the sharp increase in long term interest rates caused all credit assets to be revalued. Uncertainty about the direction of the economy, and of Fed policies, remains the dominant factor in the market, and could continue to cause volatility in loan asset prices for many months to come, but also creates opportunities for capital appreciation. However, demand and supply for Leveraged Debt remains very strong and credit metrics continue to improve.

IT WAS A VERY GOOD YEAR (AND A HALF)

Let's review how we did in each phase, beginning at the very beginning. The Fund performed very well in the Recovery phase, which may even be an understatement. At one point, the Fund was up over 100% in less than 18 months! According to Morningstar, we were one of the top performing investment funds in the country. The secret to our early success was that we were highly bullish about the Business Development Company sector only months after prices had dropped to their lowest levels ever, and distributions had been cut by 52%. We had been personally invested in the BDC sector both before and during the Great Recession, and were highly confident many companies were greatly undervalued. (That seems obvious now, but at the time there was considerable skepticism in the media and the markets about the economic recovery, and a "double dip

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recession" or catastrophic disintegration of the financial system appeared probable to many observers).

Our confidence was partly based on the original reasons we began to invest in the BDC sector in 2003-2005. The BDC business model, thanks to the rules the Congress set in 1980, limits leverage and maximizes portfolio diversification. Furthermore, we were convinced the blue-chip private equity groups which managed the 20+ companies involved in the sector at the time had the experience and capital to navigate any crisis.

None of the above stopped the BDC sector from suffering severe stock price losses from mid 2008 to mid 2009. However, based on old-fashioned reading of the public filings of the BDC companies we were tracking, as well as crunching mountains of data, we were convinced that a bottom had been reached in mid-2009 and almost every company in the sector was greatly undervalued. We argued, in launching the Fund, that we would benefit both from higher distributions and higher asset values.

Our outsized success in the Recovery Phase was not only due to investing in BDC common stocks, but also to our use of leverage at a time when the technique was out of favor. We argued the Fund should take full advantage of this "once-in-a-generation" opportunity in the BDC sector by using margin borrowing to increase the total size of our portfolio by 2x. This was at a time when many investors had been badly burned by using leverage during the Great Recession.

However, the way in which investors had used, and abused, leverage in the 2006-2008 period was different than the way we proposed to proceed, and under very different macro-economic conditions. Back in the go-go days, debt investors frustrated by low margins on non-investment grade loans (thanks to a strong economy) borrowed to buy individual commercial loans. When the recession began, the value of these loans began to drop, causing the owners to seek to sell them into an illiquid market. Loan prices, which had been stable for many years, dropped 30-50% because of the mismatch of supply and demand. Not helping valuations were the low spreads on many of the loans at a time when new loans were being made at very high rates. Many hedge funds and other forced sellers (including banks needing to de-leverage) lost large amounts. "Never again" became the motto in many parts of the market.

In the IVQ of 2009, as just after everybody else was getting out of the use of leverage, we were getting in, but with a twist. We were not buying individual loans, but the common stock of a Business Development Company, which owns a portfolios of loans. We added to the diversification by investing in as a wide a swathe of investments as possible, including other forms of Leveraged Debt (High Yield Bonds and Floating Rate Loans). Furthermore, all our investments were publicly traded, making getting in and out of our positions much easier, and the yields they were generating were very high: 10.0% or higher.

Furthermore, we benefited from favorable macro conditions. Since late 2008 the Fed had reduced short-term rates to near-zero. We believed, when launching the Fund, that the Fed would keep short-term rates very, very low for an extended period. Even if we were to be proved wrong and the Fed was to raise rates earlier than we anticipated, we calculated the "spread", (or differential between the yields received on loan assets and the cost of margin borrowing) was so high as to provide a great deal of protection. Finally, we could always sell off our assets and de-leverage on very short notice.

We were right, both about the direction of BDC performance and the use of low-cost leverage, for an extended period. Admittedly markets were very volatile. On occasions asset values would drop (the first Greek crisis in May 2010-anyone remember that?), which caused the Fund to incur outsized losses because of the use of margin. We were down -19.3% in May 2010, but up 24.4% two months later (the S&P down -8% and up 7% respectively as point of contrast). However, in down markets we would de-leverage slightly to remain in compliance with our borrowing agreement, and re-leverage when markets turned up again. As we projected, distributions increased, and the number of BDCs that we believed were safe to invest back into again grew in number.

A roller coaster it may have been, but there was no arguing with the results. At February 2011, the Fund's Inception To Date return was (gulp): 108.9%. We were outperforming the S&P 500 by more than 300%!

EVERYTHING GOES TO HECK

The Market Meltdown phase began in the summer of 2011. We had a brief problem month with the Japanese earthquake in March, but the Fund bounced back, as it had done in every crisis before, in April. However, from May 2011, the Fund was down every month till the end of November.

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We've covered this ground before in previous Newsletters. It's difficult to discuss (we enjoyed writing about Phase 1 a lot more), but we have spent a huge amount of time then and since deconstructing what we did wrong. We couldn't help that the BDC sector (and virtually all other assets) dropped in value. Between the end of April and November 30th, the BDC sector dropped -19% in value (and 28% from the highest to the lowest point).

What we shouldn't have done (we have since concluded) is stick with the strategy that brought the huge returns the years before: buying into a weakening market. Our analysis of the BDC sector suggested the fundamentals were improving, notwithstanding the macro conditions. We stayed active, seeking to capture the remaining upside that we projected in the Realizable Value of many investments, and to continue to enjoy the high distributions (which were just going higher) from our investments.

However, months of lower prices brought on by the Euro-crisis took a heavy toll on the Fund. For the first time, we incurred a very high level of Realized Losses, and had to reassess our investment strategy of seeking to remain fully leveraged, regardless of macro conditions.

IMPROVING INVESTMENT MANAGEMENT

We made three critical changes to the Fund's investment strategy in response to what we learned in 2011:

1. We decided to broaden and diversify the Leveraged Debt sectors in which we invest to mitigate the impact of a sell-off in BDC common stocks. We added or increased our exposure to BDC Notes (which only became available in 2012), High Yield Bonds and Floating Rate Notes. All the additional sectors have many similarities with BDC Common Stocks, but all have historically been less volatile during market downturns.
2. We increased the total number of prospective investments tracked and invested in to mitigate the downside risk on individual investments, and to more easily be able to trade in and out on short notice.
3. We decided to proactively de-leverage the Fund at times of above average market turmoil and uncertainty to reduce exposure to potential market sell-offs.

BOUNCING BACK

Nothing underscores how the Euro-crisis had artificially depressed all asset prices is how quickly asset prices rose as concerns about a potential implosion of the world economy receded in 2013. The stock market indices were up 25% and more. Leveraged Debt asset prices were up too: High Yield Bonds were up just under 6%, and Floating Rate Loans just over 6% in the period. The BDC sector was up 30%!

The Fund performed very well in the Rebound Phase. From January 1, 2012 to April 30, 2013 the Fund was up 35.7%, beating out even the stock market indices. Admittedly, though, performance reflected the more cautious, diversified approach adopted at the end of 2011. If we'd stayed exclusively in BDCs, and been triple leveraged, performance would potentially have been higher. However, we would have faced several drawdown periods where BDC prices dropped sharply. For example the BDC sector was down -6.7% between April 27, 2012 and May 18, 2012 (Greek elections); down -9.3% in November 2011 (Obama re-election) and -8.9% in April of this year. Multiplied by 3x, the potential drawdowns would have neared 30% of partner's equity. Instead, thanks to our revised approach, we greatly reduced our "drawdown". In May 2012, thanks to Greece, we were down "only" -6.5%, and made up the loss in the two months that followed. Likewise, when the markets panicked after the President's re-election (higher taxes!), we were down -6.4%. Again we made up the loss and more within the next 2 months, and still had a 28.2% gain on the year.

As per our new policy, we frequently de-leveraged the Fund during unstable market conditions and/or strategically shifted the mix of volatile and less volatile investments. At one point during the May 2012 Greek elections crisis we sold off 60% of the Fund's assets as a precaution. We also quadrupled the number of investments in the portfolio

Another phenomenon worth noting is that in the Rebound Phase, the Fund has been much quicker than in the past to book Realized Gains when investments increase close to Realizable Value. We calculate that the Fund has booked gains in the 16 month period equal to 12% of partner's average capital over the period, and sufficient to offset a fifth of the losses incurred in the Meltdown Phase.

ADJUSTMENT PHASE

We are just 5 months into the latest phase where interest rates are on the rise, causing all Leveraged Debt assets (and most yield investments) to re-price.

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Asset prices have been very choppy, up one month, down the other across all sectors. Overall, though, all the Leveraged Debt sectors are down since the end of April. The relative best performer is the BDC sector down only -2.3%, followed by BDC Notes, High Yield Bonds (down -6.3%) and Floating Rate Loans (down -10.3%).

Nonetheless, the Fund has performed well, managing to eke out 2 winning months out of 5. That's been accomplished by keeping the Fund under-leveraged, and taking profits when available. We are coming very close to making a profit in a down market.

CONCLUSION

Looking back, we can say that we were right about most everything:

1. We were right that the BDC sector, and the Leveraged debt industry generally, was undervalued in 2009, and would recover.
2. We were right that all the Leveraged Debt sectors we invest in would generate steady, dependable income.
3. We were right about being using leverage to borrow cheaply and invest in high yield assets to capture very high levels of dividend income. Over our four year history, the Fund has received dividends equal to 129% of partner's capital, which is an amazing statistic.

We were wrong in how we managed the Fund during the Euro-Zone crisis, as the results for that period show. However, it's a testament to the resilience of our business model that the Fund has still managed a 32% return overall. Of course, we make pointless calculations in our heads every day about what our aggregate returns would be today if he hadn't had our 2011 mis-step...

NEXT MONTH

That was then, but what's more important for all of us is what comes next. Next month, we look forward and project out what we intend to achieve in the years ahead, knowing what we know now. Spoiler Alert: we are optimistic that we have the right formula to exceed the performance of the last 4 years, and with less volatility to boot.

NEWSLETTER

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

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