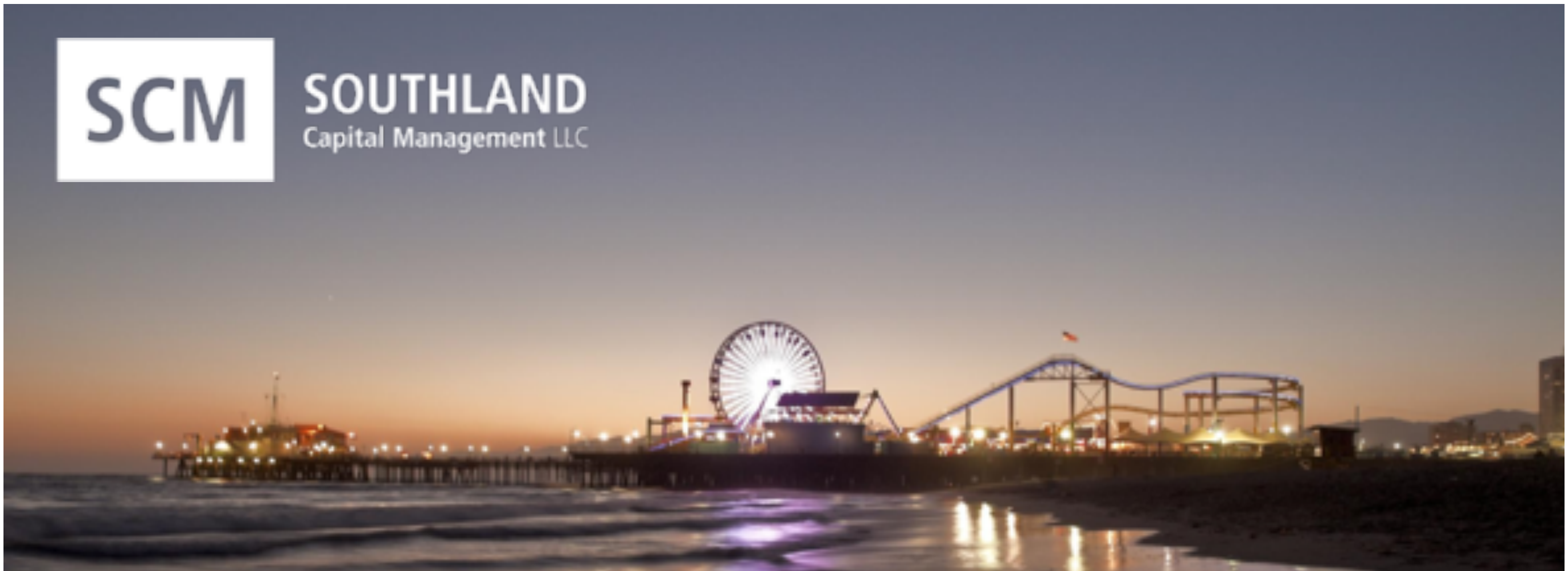

Month	BDC Fund II*	S&P 500 TR	NASDAQ Comp	Dow Jones	Russell 2000 (DRI)
FYE - 2009	4.37%	5.49%	6.91%	7.37%	3.49%
FYE - 2010	73.04%	15.07%	16.91%	11.02%	26.85%
FYE - 2011	-46.38%	2.11%	-1.8%	5.53%	-4.18%
FYE - 2012	28.21%	16%	15.19%	7.25%	16.34%
FYE - 2013	13.20%	32.41%	38.33%	26.51%	38.82%
Inception to Date	40.54%	91.38%	96.81%	70.68%	103.91%

* 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.

DECEMBER 2013 Results

The Fund was up 0.49% in December, the fourth positive month in a row. (For the year, the Fund recorded 9 positive months and 3 down months). However, all the stock market indices were up far more in the month, capping a remarkable year for stocks. The top performer in December was the Dow Jones: up 3.05%.

For the year, the Fund was up 13.20%, making up all the losses incurred by the debt market's temper tantrum of May. Of course, the stock market indices were substantially higher on the year. Small cap and technology stocks boosted the Russell 2000 and NASDAQ to returns of 38.82% and 38.33% respectively. The S&P 500 was at a still record-breaking 32.41% gain and the lowest performing index, the Dow Jones, at 26.51% was still twice higher than the Fund.

Inception To Date (52 months), the Fund is up 40.54%. Thanks to the 2013 performance, we lag the indices over this bull period run. The Russell 2000 is up 103.91%! The relative under-achiever is the Dow Jones up 70.68%.

Every month for many months now we also compare the Fund's performance since the re-adjustment of our investment strategy from January 1, 2012 on. In that two-year period we are up 35.54% after all fees and expenses, just a whisker behind the Dow Jones at 35.69%. However, the other indices are materially ahead with the Russell 2000 leading the group, up 61.5%.

Compared to our "hedge fund" brethren, the Fund had an excellent year. There are multiple publicly reported indices. One will do for all: The HFRI Fund Weighted Composite Index indicated the average fund was up +9.3 percent in 2013, as reported by "HFR, the established global leader in the indexation, analysis and research of the global hedge fund industry". Thus, BDC Fund II was a respectable 42% above the average "hedge fund" performance.

OUTPERFORMING IN A DOWN MARKET

We know, we know. 2013 was the Year of Stocks, with all the indices up by percentages not seen in years. The increase in the NASDAQ was the highest since 2009, the S&P 500 since 1997 and the Dow Jones since 1995. However, BDC Fund II does not invest in Apple, Tesla, Priceline and all. We invest in publicly traded debt investments, whose performance was the antithesis of regular common stocks. Most debt investments had a terrible 2013: 20 Year Treasuries were down -14%, Municipal Bonds down -3.3% and Investment Grade Corporate Debt -1.6% (Source: Barron's January 2, 2014).

As a long-term investor, we're not concerned or surprised that stock performance was so far greater in 2013 than debt investments. Debt had its day in the sun in 2009, when the Credit Suisse Leveraged Loan Index was up 44.8%, and the High Yield Bond Index was up 57.3%.

Month	BDC Fund II	S&P 500	NASDAQ Comp	Dow Jones	Russell 2000 DRI
Jan 2012 to Date	35.54%	53.60%	60.34%	35.69%	61.50%

Of course, these spectacular increases in both the stock and debt markets are because both dropped dramatically in the Great Recession, and have taken different paths to recovery. Anyone who's had a look at the long-term performance of the major asset classes knows that performance evens out over time. One example will do to illustrate our point: Since 1997, S&P 500 stock returns have averaged 8.2% per annum compared to 7.8% for High Yield Bonds, 6.6% for Investment Grade Bonds and 6.1% for Treasuries.

TORTOISE VS. HARE. GUESS WHICH ONE WE ARE?

It may sound like hubris, but we continue to believe that the Fund will out-perform the stock market indices over the long term, notwithstanding 2013's results. Our confidence is based upon the nature of debt investments, which over a long period generate their return from interest income generation. Like Aesop's tortoise, debt investments plod along slowly racking up interest, while stocks shoot ahead like the hare, but can take long rests where they earn nothing. Of course, there's more to investing in non-investment grade debt than being patient. We, like any investor, have to know when to "hold 'em, and when to fold 'em". As we'll show below, 2013 was a difficult year in that regard, but we managed to greatly outperform every other debt class, and most every other type of investment out there. Except stocks.

COUPON CLIPPING YEAR FOR NON-INVESTMENT GRADE DEBT

We stayed focused on maximizing our returns within the non-investment grade bailiwick in which we operate. In 2013 the non-investment grade sectors in which we specialize performed marginally better than most forms of debt referred to above, but there was precious little price appreciation. On a total return basis (which includes both interest and price movement) the **High Yield Index** was up 7.6%, the **Floating Rate Loan Index** up 5.3% and the **Wells Fargo BDC Index** up 7.3%. Essentially, these debt investments were flat for the year, with virtually all the return coming from interest income generated. (Performing worse were Closed End Funds in both High Yield Bonds and Floating Rate Loans, which were out of favor for most of the year and dropped in value by -2.5% and -6.5% respectively, eroding much of their interest income).

Thanks to BDC II's business model, and a number of critical investment decisions through the year, the Fund achieved results far superior to the sectors in which we invest, even after all fees and expenses, and despite our exposure to the slumping CEF market. On a gross basis (before management fees and expenses), the Fund achieved a gross yield of 19.8%.

Here are the reasons why:

1. Use of leverage: In a flat market, BDC II's use of leverage amplified returns from income. In 2013, we achieved a 22.50% dividend return on average equity: that's more than 3x the average yield of Business Development Companies, 4x the average yield on High Yield Bonds and 5x the yield on Floating Rate Loans.

As has been the case for the past 4 years, the cost of the margin debt we used was very, very modest: less than 10% of the dividend + interest income generated, as we are paying a rate of interest of 1.0%. Nor did we max out the Fund's leverage capability to achieve these very high levels of dividend income. For risk management reasons, throughout the year we remained well short of being fully leveraged. At year-end we were levered 2.7 : 1.0.

2. Diversification by sector: We don't pretend to know from day to day or week to week which non-investment grade sector prices will rise and fall. Instead, we allocate our assets across multiple sectors to diversify our exposure to market changes. If we had been only in Closed End Floating Rate Loan Funds in 2013, we'd have made no profit at all. If we'd been only in High Yield Bond Exchange Traded Funds in May we'd have been down -7.5% in 6 weeks (22.5% if we had been triple leveraged).

We would rather be diversified and achieve results that include both up trending and down trending than take a big bet on one sector alone and potentially take a bath. It's an approach that has worked well for us over the past two years. At the same time, we do not blindly invest across sectors. We are watching stocks and sectors virtually every minute of every day, and recording the changes in real-time in our proprietary database. When everybody else is at the office or the beach, we have our fingers at the ready (literally) to shift asset allocations, both to reduce risk and to take advantage of opportunities.

GREATEST HITS

We made a number of key allocation calls during 2013 that paid off, and one that did not (yet). First, we began the year fully allocated (3.0x leverage) across all debt classes just as credit investments enjoyed several months of price

appreciation, as markets assumed low interest rates were with us indefinitely and marked up anything paying a decent yield. As a result, we had an excellent January: up 6.6% in just one month, and positive results in every asset class. Second, we stayed bullish on **BDC common stocks** even after they peaked in March, and dropped -8.9% in the next 30 days. The sector rallied, only to be caught up in the big drop-off in all credit investments when long-term interest rates rose. Nonetheless, we stuck with BDC common stocks (which we believed were mostly under-valued), and the sector rallied as much as 11.1% in the second half of 2013. According to data generated by **PartnersAdmin**, which analyzes the respective contribution to our earnings of the different sectors, our faith in BDC common stocks was rewarded, and contributed 50% of the Fund's earnings in 2013.

We did not get any advance warning in May from the markets that the Fed's musings about "tapering" quantitative easing would cause interest rates to jump from 1.6% to 3.0% in just 4 months, an increase of 82%. We were just as surprised as everyone else by the seismic shift in rates and credit pricing. However, our presence on the front lines meant we were quick to dispose of all our long term, fixed rate assets, both in High Yield and BDC Notes, early in the ensuing bloodbath. Long dated bonds likes **Ares Capital's** 2042 Notes dropped 12% or more (an Apollo long dated Note dropped 23%). Even investments such as the iconic High Yield ETF with the ticker **HYG** (usually used as the poster child for the sector) was down -7.6% (more than a year's worth of interest payments) in about a month. We watched the damage from the sidelines, as we exited those investments early. (Despite a High Yield rally since September, none of those investments have returned to their previous May 2013 highs). BDC Notes, as well as High Yield Bonds, contributed 31% of our net earnings in 2013, despite the worse conditions for fixed rate instruments in a generation.

Throughout the year, we bought and sold the stock of non-dividend American Capital, a BDC which is also a Private Equity and Asset Manager. We had some early gains and losses. In the fourth quarter, we broadened our investments to include several other publicly traded Private Equity Asset Managers (names like KKR and Blackstone) and were rewarded with both distributions and across the board price appreciation. Asset Managers represented only a small portion of our portfolio, but contributed 18% of our net earnings in the year.

WHAT DIDN'T GO SO WELL

After all this patting ourselves on the back, it wouldn't be fair not to mention what didn't work out so well. First, our attempt to hedge ourselves against higher interest rates by using an inverse ETF (one that goes up in price when rates do) with the ticker SJB was not successful. Yes, the investment made money in the darkest days of May and June, but the 7% increase was not consolation enough for the erosion in price that followed. We decided to exit stage left towards the end of the year and disposed of SJB, which was our largest single position loss maker in the year, contributing a loss equal to -1.1% of total equity. As we've proven, we have many other ways to protect the portfolio against higher interest rates (changes in allocation, selling off assets) than long-term holdings of inverse positions.

From a sectoral viewpoint, the only other misstep in 2013 were Floating Rate Loan Closed End Funds. We had surmised that Floating Rate Loans would eventually be the big winners when interest rates rose, as their distributions will increase as short term rates go up. Certainly that was the opinion amongst investors in Floating Rate Exchange Traded Funds, which had a very steady year.

However, CEFs, which had enjoyed the favorable yield party from January to April, took a shellacking in the months that followed. By November the segment was down -20% in price terms. Thankfully, we didn't do as badly as you might expect. After a few months of buying what we hoped were bargains as prices dropped, we took a few profits where available and stopped adding to our position. In December, prices began to rise and throughout the year, of course, we collected decent levels of interest income. We ended the year with a -0.71% loss as a percent of equity. (We remain bullish on the sector, and have been partly vindicated in January as prices so far have risen across the board).

Overall, though, our sectoral missteps had a minor impact on our full year results. (It helps that debt investments continue to pay interest even when their stock prices are down). Without the losses on SJB and Floating Rate Loan CEFs our earnings for the year would only have been 5% higher. Not to belabor the point, but that demonstrates why sectoral diversification works.

3. Diversification of investments: Most hedge funds invest in relatively few investments, with the hope that a few successful big bets will create superior returns. We are different. We deliberately limit our exposure to any one investment to 5% of the Fund's total equity. (The only exceptions are a couple of investments in very diversified and very liquid Floating Rate and High Yield Bond investments). As a result, we have 60-70 different investments on the books at any time. In turn, each of those investments will hold an average of 100 or more different loans in portfolio. Some of our investments have portfolios of several hundred loans or bonds. As a result, the Fund's capital is effectively invested over thousands and thousands of loans.

This hyper-diversification protects us from being too affected by the inevitable bad debts that occur in the credit world and from the ups and downs of stock prices. Unlike the stock market in general, 2013 was not an easy year in most of our segments to pick winners and losers. For example, out of 36 BDCs we track, 14 were down on the year. Of the 22 BDC notes we track, 14 were down, and only 8 were up. The situation was even worse where Floating Rate Loans and High Yield Bonds were concerned. We track 15 Floating Rate investments, and only 2 saw their price rise in the year. In High Yield Bonds, of 22 investments 12 were down and 10 were up. Amongst individual investments there were some big losers in the year. Of the 109 investments we track, 29 were down -5% or more. Of those, more than a third saw losses greater than -10%. (The Biggest Loser, to give a context, was off -17.7%).

DISCOUNT BUYER

A Fund which made big individual bets might have done very well or very poorly. Thanks to our diversification, we managed to achieve net positive capital gains (that's calculated as Realized Gains less Unrealized Losses) in a very difficult year, and without "betting the farm". One of the critical factors in our success is that we maintained our discipline around buying and selling investments. For every investment we track, we have a target price (we call "Realizable Value"), which reflects our estimate of a fully valued stock. Our policy during 2013, where the more volatile, higher yielding investments were concerned, was to invest only in stocks trading AT LEAST at a 10% discount to Realizable Value. Furthermore, our policy was (and is) to dispose ourselves of investments, which reached Realizable Value, rather than face the risk of seeing their prices plummet when market conditions change.

Market volatility will usually give us the opportunity to have another bite at the apple before long.

This worked out very well for us, with many successes registered in the year. Overall, the Fund had Realized Gains from selling investments at a price above cost equal to 5% of average equity. Realized Gains net of Unrealized Losses was also positive, and contributed 5% of the Fund's total income in a year where we could easily have been deeply in the red. (At one point, our Unrealized Losses were twice as high as we ended in December).

CONCLUSION

2013 was a vindication of the Fund's strategy and approach. In a down year for credit investments and a flat year in price terms for non-investment grade debt where as many investments were down as were up, the Fund was able to achieve a 20% gross return on equity, and earn investors a net return in the teens. This was achieved with only 2 months of major volatility (May and August), with the Fund posting positive returns 75% of the time. Over two years, the Fund is up 35.5%, or the equivalent of 1.5% a month, after all costs. At this pace, the Fund will double an investor's return in five and a half years, which is almost in line with our quixotic goal of doubling every five years. We are hopeful that, barring any "black swans", 2014 will confirm the Fund's ability to achieve superior returns to most every other type of investment class over time. Even stocks.

NEWSLETTER

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

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