INVESTMENTS®

Q2 Fund commentary

As of 6/30/2018

FS INVESTMENT CORPORATION II

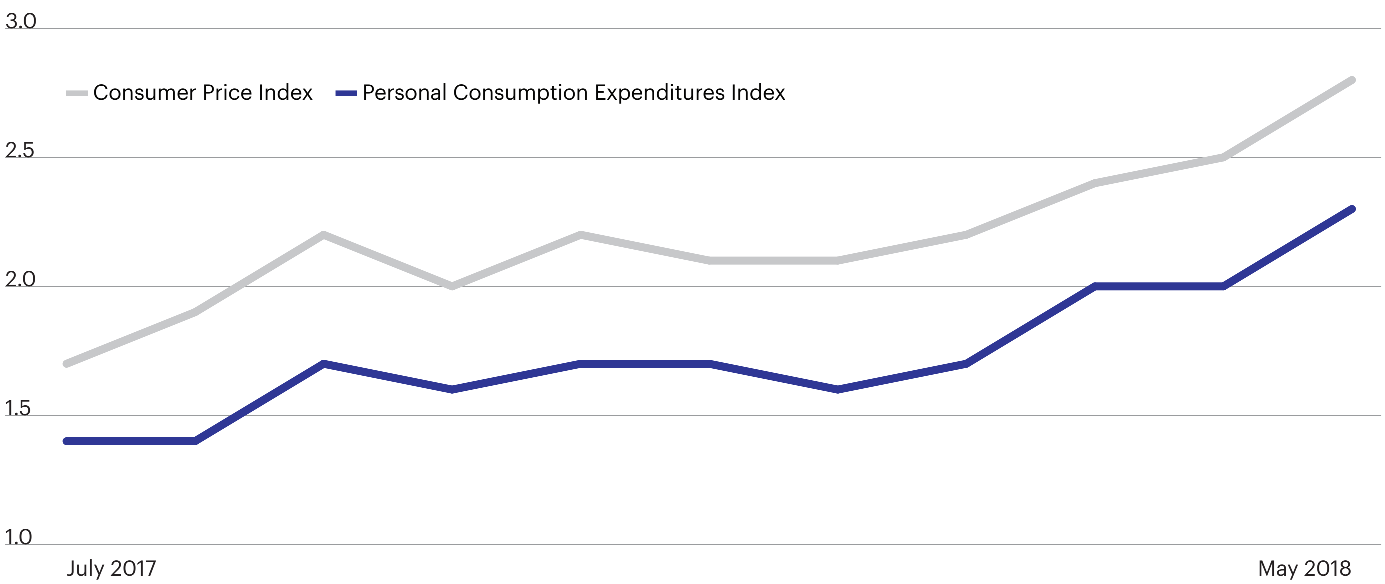
Summary

- U.S. economic growth accelerated during the second quarter of 2018, led by historically strong labor markets. However, corporate credit and equity markets experienced further volatility as both interest rates and trade tensions rose during the quarter.
- After outperforming high yield bonds for the past two quarters, senior secured loans returned 0.8% during the second quarter compared to 1.0% for high yield bonds.[1] Returns for both asset classes far outpaced investment grade bonds, which returned -0.9%.[1]
- FS Investment Corporation II (FSIC II, or the Fund) generated a stockholder return (without sales charge) of 1.0% for the quarter ended June 30, 2018, compared to 0.8% for senior secured loans.[1,2]

Market review

Historically strong labor markets and better-than-expected retail sales data led to robust economic growth during the second quarter of 2018. In May, the yield on the 10-year U.S. Treasury note reached a seven-year high of approximately 3.11% as the Fed upgraded its economic outlook for 2018 and raised its median estimate for rate hikes this year from three to four.[3,4] Treasury yields ended the quarter at approximately 2.9%.[3] Markets remained volatile, however, as trade tensions between the United States and China escalated during the quarter and inflationary pressures solidified. Both the Consumer Price Index and Personal Consumption Expenditures Index rose well above the Fed's preferred 2% inflation target during the quarter.

INFLATIONARY PRESSURES ON THE RISE



Source: Bloomberg.

An investment in FSIC II involves substantial risks. For a summary of these important risk factors, please turn to page 4 or click here.

U.S. economic growth picked up steam during the second quarter as the unemployment rate dipped as low as 3.8%, a level last seen in the late 1960s.[5] Retail sales reached an annualized growth rate of 5.9% in May, which was double economists' forecast and the highest reading this year.[6] At its June meeting, the FOMC raised the target federal funds rate, as it has for each of the past three quarters.[7] In their statement accompanying the June rate hike, policymakers removed language noting that the federal funds rate would remain stimulative, or below its longer-run level, "for some time."[7]

After outperforming high yield bonds for the past two quarters, senior secured loans returned 0.8% during the second quarter compared to 1.0% for high yield bonds and -0.9% for investment grade bonds.[1] As interest rates have risen this year, senior secured loans have drawn significant investor interest due to their floating rate coupon and position as a potential hedge against rising interest rates. Year to date, bank loan mutual funds have seen inflows of approximately $8.5 billion while senior secured loans have generated returns of 2.4%.[1,8] In the same time period, high yield bonds have experienced outflows of $18 billion and generated total returns of just 0.1%.[1,8] Rising rates have negatively impacted the performance of higher duration investments. Investment grade bonds have returned approximately -3.1% year to date while the Bloomberg Barclays U.S. Aggregate Bond Index, a benchmark that measures performance across the traditional fixed income investment landscape, has returned -1.6%.[1]

Performance review

> Since its inception on June 18, 2012 through March 31, 2018, FSIC II's annualized stockholder return is 7.5% (without sales charge) and 5.7% (with sales charge).[2] By comparison, senior secured loans returned 4.9% and high yield bonds returned 6.4% during the same period.[1]

Throughout the second quarter of 2018, FSIC II maintained its focus on senior secured, floating rate investments, which we expect will help drive long-term performance and provide downside protection in the event of further credit market volatility.[9] FSIC II paid distributions of approximately $0.19 per share during the quarter ended June 30, 2018, representing an annualized distribution rate of 8.87% based on the Fund's distribution reinvestment price (DRP) of $8.50 per share as of quarter-end.[10] The Fund's DRP was lowered by $0.10 per share from $8.60 to $8.50 per share effective June 29, 2018, reflecting a decline in FSIC II's underlying net asset value (NAV). The Fund generated a stockholder-based total return (without sales charge) of 1.0%, matching high yield bonds during the quarter and outpacing senior secured loans' returns of approximately 0.8%, as distributions paid during the quarter exceeded the depreciation in the Fund's NAV.[1,2]

The Fund's NAV decline was driven largely by unrealized depreciation in a select number of holdings. Specifically, directly originated investments in an aerospace manufacturer and a chemical engineering company represented the majority of the decline during the quarter.

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Conclusion

We formalized our partnership with KKR in April to manage all FSIC funds, including FSIC II, as well as the business development companies (BDCs) currently managed by KKR, Corporate Capital Trust and Corporate Capital Trust II. We believe the scale and breadth of our platform is a significant advantage going forward as we expect increased competition in the middle market and consolidation within the BDC sector.

As part of the partnership, FSIC II can now co-invest across the full breadth of KKR Credit's platform, which we believe will create access to expanded deal flow and new sources of income and return. We believe the certainty, stability and scale of the partnership, along with the expansion of our internal credit investment team, will help create value for our investors. We remain focused on optimizing the combined FS and KKR platforms.

STOCKHOLDER RETURNS AS OF 6/30/2018

(without sales charge), compounded monthly						(with sales charge), compounded monthly	
YTD	**1 year**	**3 year** (annualized)	**5 year** (annualized)	**Since inception** (annualized)	**Cumulative total return since inception**	**Cumulative total return since inception**	**Inception date**
0.9%	1.8%	5.1%	6.4%	7.5%	55.0%	39.5%	June 18, 2012

Stockholder returns (without sales charge) are the total returns an investor received for the highlighted period taking into account all distributions paid during such period, compounded monthly. Except for the YTD, 1-year and 3-year periods, the calculation assumes that the investor purchased shares at FSIC II's public offering price, excluding selling commissions and dealer manager fees, at the beginning of the applicable period and reinvested all cash distributions pursuant to FSIC II's distribution reinvestment plan (DRP). Since FSIC II closed its public offering in March 2014 and has since issued new shares only pursuant to its DRP, the calculation of FSIC II's stockholder returns (without sales charge) for the YTD, 1-year and 3-year periods assumes that the investor purchased shares at the beginning of the applicable period at a price based upon FSIC II's DRP on such date. Valuation as of the end of each period is the redemption price pursuant to FSIC II's share repurchase program on such date. Stockholder returns (without sales charge) do not include selling commissions and dealer manager fees, which could total up to 10% of FSIC II's public offering price. Had such selling commissions and dealer manager fees been included, performance would be lower. Upon liquidation or redemption, market conditions may cause the actual values to be more or less than the values shown.

Stockholder return (with sales charge) is the total return an investor received since inception taking into account all distributions paid during such period, compounded monthly. The calculation assumes that the investor purchased shares at FSIC II's public offering price, including the maximum selling commissions and dealer manager fees, at inception and reinvested all distributions pursuant to FSIC II's DRP.

Valuation as of the end of each period shown above is the repurchase price pursuant to FSIC II's share repurchase program on such date. Upon liquidation or repurchase, market conditions may cause the actual values to be more or less than the values shown.

FSIC II is closed to new investors. FSIC II's total expenses as a percentage of average net assets attributable to common stock was 9.10% for the year ended December 31, 2017.

An investment in any fund sponsored by FS Investments involves significant costs, and investors should review the information in the applicable fund's prospectus regarding fees and expenses.

Note: All figures may be rounded. Returns shown are historical and are based on past performance. Past performance is not indicative of future results.

1 Total returns are based on indices and represent income from regular interest and dividend payments and appreciation in market value with respect to the securities included in the indices. Indices used: high yield bonds – ICE BofAML U.S. High Yield Master II Index, which is comprised of U.S. dollar-denominated below investment grade corporate debt securities publicly issued in the U.S. domestic market; investment grade bonds – ICE BofAML U.S. Corporate Master Index, which is comprised of publicly issued, fixed-rate investment grade corporate debt; senior secured loans – Credit Suisse Leveraged Loan Index, which is an index designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market; 10-year U.S. Treasuries – ICE BofAML 10-year U.S. Treasury Index, which measures the total return of the 10-year U.S. Treasury note. This data is for illustrative purposes only and is not indicative of any investment. An investment cannot be made directly in an index.

2 Please see the table above for a description of how FSIC II's stockholder returns (without sales charge) and stockholder returns (with sales charge) are calculated.

3 10-year U.S. Treasury note, https://bit.ly/29ecBfp.

4 U.S. Federal Reserve Summary of Economic Projections, June 2018, https://bit.ly/2sY5hgK.

5 Bureau of Labor Statistics, https://bit.ly/2ibnFLh.

6 U.S. Department of Commerce, https://bit.ly/Y4FaTF.

7 U.S. Federal Reserve, June press release, https://bit.ly/2LQmtfn.

8 J.P. Morgan High-Yield and Leveraged Loan Morning Intelligence as of June 29, 2018. Based on data from Thomson Reuters Lipper.

9 Although senior loans in which FSIC II invests may be secured by specific collateral, there can be no assurance that the collateral will not decrease in value or lose its entire value over time, which may have a financial impact on FSIC II.

10 The annualized distribution rate shown is expressed as a percentage equal to the projected annualized distribution amount per share (which is calculated by annualizing the distribution amount per share of $0.19 paid in the quarter ended June 30, 2018, without compounding), divided by FSIC II's distribution reinvestment price per share of $8.50 as of June 30, 2018. The annualized distribution rate may be rounded. The payment of future distributions on FSIC II's shares of common stock is subject to the discretion of FSIC II's board of directors and applicable legal restrictions and, therefore, there can be no assurance as to the amount or timing of any such future distributions. For the quarter ended June 30, 2018, 100% of FSIC II's distributions were funded through net investment income on a tax basis. No portion of FSIC II's distributions during the quarter ended June 30, 2018 was funded through expense reimbursements from FSIC II's sponsor. The determination of the tax attributes of FSIC II's distributions is made annually at the end of FSIC II's fiscal year, and a determination made on an interim basis may not be representative of the actual tax attributes of FSIC II's distributions for a full year. The actual tax characteristics of distributions to stockholders are reported to stockholders annually on Form 1099-DIV.

RISK FACTORS

Investing in FSIC II may be considered speculative and involves a high level of risk, including the risk of a substantial loss of investment. The following are some of the risks an investment in FSIC II's common stock involves; however, you should carefully consider all of the information found in Item 1A of our annual report on Form 10-K entitled "Risk Factors."

- Because there is no public trading market for shares of FSIC II's common stock and FSIC II is not obligated to effectuate a liquidity event by a specified date, if at all, it is unlikely that you will be able to sell your shares. If you are able to sell your shares before FSIC II completes a liquidity event, it is likely that you will receive less than you paid for them. While FSIC II intends to conduct quarterly tender offers for its shares, only a limited number of shares will be eligible for repurchase and FSIC II may amend, suspend or terminate the share repurchase program at any time.
- FSIC II invests in securities that are rated below investment grade by rating agencies or that would be rated below investment grade if they were rated. Below investment grade securities, which are often referred to as "junk," have predominantly speculative characteristics with respect to the issuer's capacity to pay interest and repay principal. They may also be difficult to value and illiquid.
- FSIC II's distributions may be funded from unlimited amounts of offering proceeds or borrowings, which may constitute a return of capital and reduce the amount of capital available to FSIC II for investment. Any capital returned to stockholders through distributions will be distributed after payment of fees and expenses.
- An investment strategy focused primarily on privately held companies presents certain challenges, including the lack of available information about these companies.
- Investing in middle market companies involves a number of significant risks, any one of which could have a material adverse effect on FSIC II's operating results.
- A lack of liquidity in certain of FSIC II's investments may adversely affect its business.
- FSIC II is subject to financial market risks, including changes in interest rates, which may have a substantial negative impact on its investments.
- FSIC II has borrowed funds to make investments, which increases the volatility of its investments and may increase the risks of investing in its securities.
- FSIC II's previous distributions to stockholders were funded in significant part from the reimbursement of certain expenses, including through the waiver of certain investment advisory fees that are subject to repayment to its affiliate, FS Investments, and its future distributions may be funded from such waivers and reimbursements. Significant portions of these distributions were not based on FSIC II's investment performance, and such waivers and reimbursements by FS Investments may not continue in the future. If FS Investments had not agreed to reimburse certain of FSIC II's expenses, including through the waiver of certain of its advisory fees, significant portions of these distributions would have come from offering proceeds or borrowings. The repayment of any amounts owed to FS Investments will reduce the future distributions to which you would otherwise be entitled.

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