PORTFOLIO MANAGER'S REPORT
For the Year Ended December 31, 2018

Mutual fund investing involves risks, including possible loss of principal. Unless otherwise specified, all information is shown as of January 25, 2019. Past performance information quoted below does not guarantee future results. The investment return and principal value of an investment in The Allocation Fund ("The Allocation Fund" or the "Fund") will fluctuate so that the value of an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted below. Performance figures reflect the deduction of expenses and assume reinvestment of dividends and capital gains but do not reflect a 2.00% redemption fee imposed by the Fund on shares redeemed or exchanged within 60 calendar days of their purchase. Most recent month-end performance and answers to any questions you may have can be obtained by calling Shareholder Services at (866) 202-2263. The Fund maintains a focused portfolio of investments in a limited number of issuers and does not seek to diversify its investments. This exposes the Fund to the risk of unanticipated industry conditions and risks particular to a single company or the securities of a single company within its portfolio. Current and future portfolio holdings are subject to change and risk. The Bloomberg Barclays U.S. Aggregate Bond Index (the "Bloomberg Barclays Bond Index") is a broad-based flagship benchmark that measures the investment grade, U.S. dollar denominated, fixed-rate taxable bond market, and includes Treasuries, government-related and corporate securities, mortgage-backed securities (agency fixed rate and hybrid adjustable-rate mortgage pass-throughs), asset-backed securities and commercial mortgage backed securities (agency and non-agency). The S&P 500 and the Bloomberg Barclays Bond Index are used for comparative purposes only, and are not meant to be indicative of the Fund's performance, asset composition, or volatility. The Fund's performance may differ markedly from the performance of the S&P 500 or the Bloomberg Barclays Bond Index in either up or down market trends. Because indices cannot be invested in directly, these index returns do not reflect a deduction for fees, expenses, or taxes. The expense ratio for the Fund reflected in the current prospectus dated March 29, 2018, is 1.00%, and may differ from the actual expenses incurred by the Fund for the period covered by the Fund's Annual Report.

Effective January 1, 2018, the Manager agreed to waive, on a voluntary basis, a portion of the management fee of the Fund to the extent necessary to limit the management fee paid to the Manager by the Fund to an annual rate of 0.80% of the Fund's daily average net asset value. This undertaking may be terminated by the Manager upon 60 days' written notice to the Fund.

The Portfolio Manager's Report is not part of The Fairholme Funds, Inc. Annual Report due to forward-looking statements that, by their nature, cannot be attested to, as required by regulation. The Portfolio Manager's Report is based on calendar-year performance. A more formal Management Discussion and Analysis is included in the Annual Report. Opinions of the Portfolio Manager are intended as such, and not as statements of fact requiring attestation.

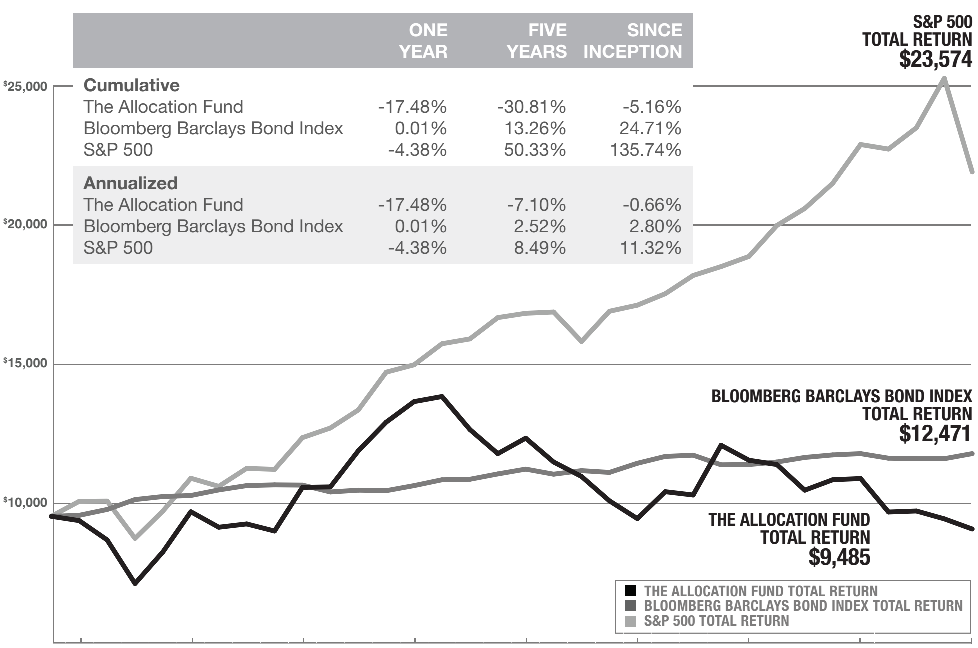
January 25, 2019

To the Shareholders and Directors of The Fairholme Allocation Fund:

Absolute and relative returns for the Fund were poor last year due to the Chapter 11 filing of Sears Holdings, below plan operating performance at Imperial Metals, and significant investor fatigue with the government's so-called conservatorship of Fannie Mae and Freddie Mac. Thankfully, the new year is off to a great start. The Fund remains focused on long-term outperformance of its relative indices by employing a non-diversified strategy.

The Allocation Fund

	ONE YEAR	FIVE YEARS	SINCE INCEPTION
Cumulative			
The Allocation Fund	-17.48%	-30.81%	-5.16%
Bloomberg Barclays Bond Index	0.01%	13.26%	24.71%
S&P 500	-4.38%	50.33%	135.74%
Annualized			
The Allocation Fund	-17.48%	-7.10%	-0.66%
Bloomberg Barclays Bond Index	0.01%	2.52%	2.80%
S&P 500	-4.38%	8.49%	11.32%



TOP ISSUERS (% OF NET ASSETS)	
Cash and Cash Equivalents*	72.2%
The St. Joe Co.	7.8%
Federal Home Loan Mortgage Corp.	5.4%
Federal National Mortgage Association	5.2%
Imperial Metals Corp.	4.3%
Chesapeake Energy Corp.	3.5%
Vista Outdoor, Inc.	1.5%

*The Allocation Fund's 30-Day SEC Yield at December 31, 2018, was 1.47% (subsidized) and 1.28% (unsubsidized).***

The chart on the left covers the period from inception of The Allocation Fund (December 31, 2010) through December 31, 2018.

The Allocation Fund decreased 17.48% versus a 0.01% gain for the Bloomberg Barclays Bond Index and a 4.38% decrease for the S&P 500 in 2018. The above graph and performance table compare The Allocation Fund's unaudited performance (after expenses) with that of the Bloomberg Barclays Bond Index and the S&P 500, with dividends and distributions reinvested, for various periods ending December 31, 2018. The value of a $10,000 investment in The Allocation Fund at its inception was worth $9,485 (assumes reinvestment of distributions into additional Allocation Fund shares) compared to $12,471 and $23,574 for the Bloomberg Barclays Bond Index and the S&P 500, respectively, at year-end. Of the $9,485, the value of reinvested distributions was $2,975.

*Includes cash, U.S. Treasury Bills, money market funds, and various commercial paper issuers.

**The 30-Day SEC Yield represents net investment income earned by The Allocation Fund over the 30-Day period, expressed as an annual percentage rate based on The Allocation Fund's share price at the end of the 30-Day period. The 30-Day unsubsidized SEC Yield does not reflect any fee waivers/reimbursements/limits in effect.

Fannie Mae and Freddie Mac (Fannie and Freddie) Preferred Stock

Fannie and Freddie's regulator and conservator, the Federal Housing Finance Agency (FHFA), believes there will be an administrative resolution of remaining issues to end, what we believe to be, a conservatorship of two of the most successful companies in the world.

We have argued for years that had the government's illegally imposed net worth sweep never been implemented, Fannie and Freddie would have predictably restored statutory capital for safety and soundness, housing markets would better meet affordability goals, and our preferred shares would be fairly priced. The judicial system also appears to be moving towards our view with Judge Willett's belief that the conservator's *"net worth sweep strips the GSEs of their capital reserves, and it is thus antithetical to the FHFA's statutory command that it 'preserve and conserve the assets and property' of the GSEs.*[1]" A conservator cannot *"bleed the GSEs profits in perpetuity.*[2]"

Despite the over 35% rise year-to-date, the preferred shares continue to trade at large discounts to potential future outcomes.

The St. Joe Company (St. Joe) Common Stock

St. Joe is a complex story about unique lands and operations in Northwest Florida. The company has a strong balance sheet, low expenses, and the ability to meet demand for decades to come with real estate surrounding the Gulf of Mexico, US Intracoastal Waterways, and Northwest Florida Beaches International Airport.

The pace of new activities continue to accelerate at St. Joe. Last year, the company initiated projects for 4,600 homes and 490 hotel rooms while expanding club and resort facilities and memberships. Many more initiatives are needed to meet growing demand for houses, apartments, limited and full-service hotels, clubs and resorts, and office space for work, life, and play in what Forbes calls "The Hamptons of The South.[3]"

Imperial Metals Corporation Common Stock

Imperial Metals is in a robust, ongoing process to assess strategic alternatives, including the establishment of a joint venture to accelerate development of a world class copper and gold mine in British Columbia. We await the results on how the company will de-lever its balance sheet and move production forward.

Chesapeake Energy Preferred Stock

Chesapeake closed the sale of their Utica acreage for approximately $2 billion, with the proceeds being applied to debt reduction. Shortly thereafter, Chesapeake announced a merger with WildHorse Resources, adding significant oil assets with the issuance of common shares. These transactions add to the margin of safety on the preferred shares owned in the Fund.

Outlook

The Federal Reserve increased interest rates by 100 basis points last year. U.S. federal and overall state budget deficits continue to soar in the midst of full employment and economic expansion. Financial markets are more volatile, but not cheap. There have been sporadic opportunities to deploy cash recently, and believe there will be more going forward. There are positive developments in certain of the issuers constituting our larger holdings and, year-to-date, the Fund is up 6.15%. The Fund's net assets stand at $74 million. Cash and cash equivalents represent 66.3% of the Fund and are available for new opportunities. I and other Fairholme-affiliates own 40.7% of total Fund shares.

Respectfully submitted,

Bruce R. Berkowitz
Manager

The Fund's investment objectives, risks, charges, and expenses should be considered carefully before investing. The prospectus contains this and other important information about the Fund, and it may be obtained by calling Shareholder Services at (866) 202-2263 or visiting our website www.fairholmefunds.com. Read it carefully before investing.

Fairholme Distributors, LLC (1/19)

[1] Collins v. Mnuchin in Fifth Circuit, Judge Willett dissent dated 7/16/2018
[2] Collins v. Mnuchin in Fifth Circuit, Judge Willett dissent dated 7/16/2018
[3] Forbes, September 1, 2018