

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 Fairholme Fund ("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 S&P 500 Index (the "S&P 500") is a widely recognized, unmanaged index of 500 of the largest companies in the United States as measured by market capitalization and the performance of the S&P 500 assumes the reinvestment of all dividends and distributions. The S&P 500 is used for comparative purposes only, and is 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 in either up or down market trends. Because an index cannot be invested in directly, the 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 1.02%, and may differ from the actual expenses incurred by the Fund for the period covered by the Fund's Annual Report. The expense ratio includes any acquired fund fees and expenses which are incurred indirectly by the Fund as a result of investments in securities issued by one or more investment companies.

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.

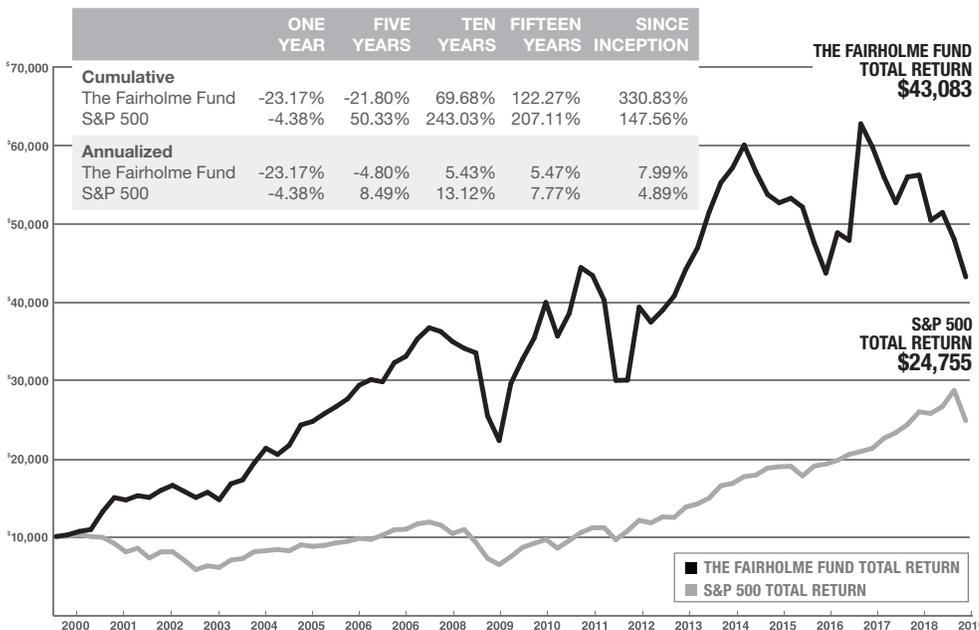
The Portfolio Manager's Report is not part of The Fairholme Funds, Inc. Annual Report due to forward-looking statements that, by their nature, cannot be attested to, as required by regulation. The Portfolio Manager's Report is based on calendar-year performance. A more formal Management Discussion and 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 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. Performance since inception tells a more uplifting story, and the new year is off to a great start. The Fund remains focused on long-term outperformance by employing a non-diversified strategy that results in greater than normal volatility.

**The Fairholme Fund**



TOP ISSUERS (% OF NET ASSETS)	
Cash and Cash Equivalents*	44.4%
The St. Joe Co.	30.3%
Imperial Metals Corp.	10.5%
Federal Home Loan Mortgage Corp.	6.5%
Federal National Mortgage Association	6.3%
Vista Outdoor, Inc.	1.1%
Sears Holdings Corp.	0.5%

The chart on the left covers the period from inception of The Fairholme Fund (December 29, 1999) through December 31, 2018.

The Fairholme Fund decreased 23.17% versus a decrease of 4.38% for the S&P 500 in 2018. The above graph and performance table compare The Fairholme Fund's unaudited performance (after expenses) with that of 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 Fairholme Fund at its inception was worth \$43,083 (assumes reinvestment of distributions into additional Fairholme Fund shares) compared to \$24,755 for the S&P 500 at year-end. Of the \$43,083, the value of reinvested distributions was \$27,943.

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

**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 profit for decades with real estate surrounding the Gulf of Mexico, US Intracoastal Waterways, and Northwest Florida Beaches International Airport.

There is 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."<sup>1</sup> St. Joe initiated a record number of projects for 4,600 homes and 490 hotel rooms while buying back common stock with excess liquidity last year. Depending on scope, projects may take between eighteen and thirty-six months to show profits.

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

Fannie and Freddie's regulator and conservator, the Federal Housing Finance Agency (FHFA), believes we will soon see administrative resolutions of remaining issues to end, what we believe to be, federal conservatorships of two of the most successful companies in the world.

We have argued for years that had the FHFA's questionable net worth sweep never been implemented, Fannie and Freddie would have predictably restored statutory capital levels for safety and soundness, housing markets would better meet affordability goals, and Fannie and Freddie preferred shares would be fairly priced. Parts of the judicial system also appear 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."<sup>2</sup> A conservator cannot "bleed the GSEs profits in perpetuity."<sup>3</sup>

Despite the over 35% rise year-to-date, the preferred shares continue to trade at what we believe are large discounts to redemption values and realistic future outcomes.

**Imperial Metals Corporation Debt & 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. Trading at less than 70 cents on the dollar and maturing in March of this year, Imperial corporate debt alone has the potential in our view to significantly increase the Fund performance should a joint venture be established with a credible strategic partner.

**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 volatile, but not cheap. There have been sporadic opportunities to deploy cash recently, and we 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 10.1%. We believe much more potential exists. The Fund's net assets stand at \$1.1 billion. Cash and cash equivalents represent 37.4% of the Fund and are available for new opportunities. I and other Fairholme-affiliates own 16.9% 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](http://www.fairholmefunds.com). Read it carefully before investing.*

<sup>1</sup> Forbes Magazine, September 1, 2018

<sup>2</sup> Collins v. Mnuchin in Fifth Circuit, Judge Willett dissent dated 7/16/2018

<sup>3</sup> Collins v. Mnuchin in Fifth Circuit, Judge Willett dissent dated 7/16/2018