Mutual fund investing involves risks, including possible loss of principal. Unless otherwise specified, all information is shown as of December 31, 2017. Past performance information quoted below does not guarantee future results. The investment return and principal value of an investment in The Fairholme Fund ("FAIRX"), The Fairholme Focused Income Fund ("The Income Fund" or "FOCIX"), and The Fairholme Allocation Fund ("The Allocation Fund" or "FAAFX"), (each being a "Fund" and collectively, the "Funds"), 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 Fairholme Fund and The Allocation 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. Each Fund maintains a focused portfolio of investments in a limited number of issuers and does not seek to diversify its investments. This exposes each Fund to the risk of unanticipated industry conditions and risks particular to a single company or the securities of a single company within its respective 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 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 a Fund's performance, asset composition, or volatility. A 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 ratios for The Fairholme Fund, The Income Fund, and The Allocation Fund reflected in the current prospectus dated March 30, 2017, are 1.03%, 1.01%, and 1.01%, respectively, and may differ from the actual expenses incurred by the Funds for the period covered by the Funds' Annual Report. The expense ratio includes any acquired fund fees and expenses which are incurred indirectly by each Fund as a result of investments in securities issued by one or more investment companies.

January 29, 2018

Dear Shareholders and Directors of Fairholme Funds, Inc.:

This past year did not go as planned for Fairholme Funds shareholders. Although markets reached new highs in 2017, there was not much to celebrate as the securities of Sears Holdings Corporation ("Sears") and Sears Canada wrecked the Funds' performance. Sears realized billions of dollars from asset sales, as we predicted, but I did not foresee the operating losses that have significantly reduced values. Getting the asset values largely correct, but missing the company's inability to stop retailing losses, has been hugely frustrating and fatiguing for me to watch. Today Sears is a much diminished position and nowhere as relevant to our financial position.

Our history since inception demonstrates that holding tight amid disappointing performance often pays. This has been the case for as long as I have run Fairholme Capital Management ("Fairholme"). On numerous occasions, long periods have elapsed before prices have matched our estimates, and I will discuss below some of the driving forces that can make this happen again. Before elaborating, I'd like you to know that Fairholme-related entities own 8.2% of The Fairholme Fund, 20.1% of The Income Fund, and 43.7% of The Allocation Fund. My family is the largest shareholder in each. I eat my own cooking and I feel the same recent disappointments as you, but I also want to share my strong belief in future outperformance. One final point: You may have already seen that effective January 1, 2018, Fairholme has voluntarily waived its annual management fees to 80 basis points.[1] We have done this in recognition of the elevated levels of cash and cash equivalents currently held in the Funds' portfolios as we await attractively priced investment opportunities.

The Fairholme Fund seeks to achieve long-term capital growth. From inception on December 29, 1999, to 2017 year-end, FAIRX returned 10.04% per annum after reinvesting dividends and realized capital gain distributions totaling $4.4 billion. At January 26, 2018, FAIRX net assets stand at $1.7 billion. 25.9% of assets are held in cash and cash equivalents, 23.2% in the preferred stock of Fannie Mae ("Fannie") and Freddie Mac ("Freddie"), 24.4% in the common stock of The St. Joe Company ("St. Joe"), 8.8% in the debt and common stock of Imperial Metals Corporation ("Imperial"), 5.2% in the common stock of Seritage Growth Properties ("Seritage"), and 5.4% in Sears' debt and equities. FAIRX also has nearly $710 million of tax-loss attributes to shelter future gains from taxes.

The Income Fund seeks current income first and capital gains second. FOCIX's total return from inception on December 31, 2009, to year-end 2017 is 8.27% per annum with the reinvestment of distributions. At January 26, 2018, FOCIX net assets stand at $271 million and comprise senior debt (both secured and unsecured), preferred stock, income-paying common shares, and investment-grade commercial paper.

(1) Effective January 1, 2018, Fairholme has agreed to waive, on a voluntary basis, all or a portion of the management fee of The Fairholme Fund, The Income Fund, and The Allocation Fund to the extent necessary to limit the management fee paid to Fairholme by each of the Funds to an annual rate of 0.80% of the daily average net asset value of the Funds ("Undertaking"). This Undertaking may be terminated by Fairholme upon 60 days' written notice to the Funds.

Credit risks are mitigated by issuers' expected cash flows and diversification. High current yields and relatively short maturities mitigate interest rate risks. Also at January 26, 37.6% of net assets are held in investment grade commercial paper yielding 2% and turning over in a few weeks. FOCIX's current yield is 5.0% and duration (the time it takes to recover invested capital) is eight months. The largest single issuer, Imperial, is 8.7% of the portfolio. Fannie and Freddie preferred stock together compose 9.4%, Seritage common stock comprises 8.6%, while Sears debt is 6.3% of The Income Fund.

The Allocation Fund seeks total return across smaller quantity ideas. From December 31, 2010, to year-end 2017, The Allocation Fund returned a disappointing 2.01% per annum with reinvestment of distributions. As of January 26, 2018, FAAFX net assets are $109 million with cash and cash equivalents at 30.3% of assets. The Allocation Fund's largest holdings are Fannie and Freddie preferred stock, which comprise 24.5% of the portfolio, while 15.7% of the portfolio is in Seritage common stock, 6.9% is in St. Joe, 4.8% is in Imperial common, 4.4% is in International Wire Group, and 3.2% is in Sears common and warrants.

Fannie Mae and Freddie Mac:

Fannie and Freddie have helped tens of millions of Americans secure affordable, predictable mortgages to help achieve the dream of financial independence while operating under the conservatorship of the Federal Housing Finance Agency ("FHFA"). Since 2012, Fannie and Freddie have shipped the entirety of their profits—$275 billion and counting—to the U.S. Treasury. You've heard this all before. The point is, with hundreds of billions in profits flowing to the federal government, there is no doubt about Fannie and Freddie's earnings power or their ability to serve the public and survive. That is why reform is coming. In a letter to the Senate this month, FHFA Director Mel Watt re-emphasized that "ongoing conservatorship is not sustainable and needs to end." He believes Fannie and Freddie should be public utilities with regulated rates of return. We agree. Treasury Secretary Steve Mnuchin tells us 2018 is the year for Fannie and Freddie reform. "We need to fix Fannie and Freddie," Mnuchin said in September. "[…] we're going to fix [them] and when we fix [them] we want to make sure we never put the taxpayers at risk." We also agree Fannie and Freddie must be returned to their private owners. So far, the Funds have realized $140 million of gains from Fannie and Freddie investments over the past four years. I would expect further gains from any Trump Administration-led initiative.

Seritage Growth Properties:

Seritage is a simple redevelopment story clouded by a complex tenant relationship with Sears. Seritage owns 40 million square feet of retail space and surrounding parking lots; Sears occupies 75% of its retail space. When Sears closes stores at Seritage locations, the real estate is re-rented at market rates three times higher to tenants such as Whole Foods and Nordstrom Rack. Proportionally higher cash distributions to owners then follow. I believe this opportunity to recapture valuable real estate is why Warren Buffett personally became one of the largest shareholders of Seritage.

Imperial Metals Corporation:

Imperial owns the Red Chris mine, which holds a mother lode of copper and gold in British Columbia, Canada. Copper is essential to the transmission of electrons. Gold has been a store of value since the beginning of time. Industry demand for copper is increasing, but mine supply growth is slowing. Demand for electric vehicles, updated electric grids and smart infrastructure will cause further imbalances without new supplies. There is renewed merger and acquisition activity in the sector, as it has become cheaper and quicker to buy assets rather than dig for them. The price of copper has moved back above $3.00. Together, these trends will boost Imperial's cash flows and valuation.

The St. Joe Company:

St. Joe is building a vibrant economic region and sustainable corporate profits with its communities across coastal Walton and Bay counties in Northwest Florida. The company is doing it the right way, with little debt, low fixed expenses, low-cost land, and $300 million of cash for the inevitable surprises of real estate development. Entitled to develop 178,000 homes and 22 million square feet of commercial space over 122,000 acres, St. Joe has a bright future, something its CEO Jorge Gonzalez and I –as the Chairman of both Fairholme and St. Joe – agree on.

There are big forces working in our favor. While Florida enjoys the country's second fastest growing population, Northwest Florida's Emerald Coast, where St. Joe owns its land, is growing twice as fast. The area has a new international airport and miles of sandy coast. Tyndall Air Force Base, which is spending $250 million and creating 1,600 new jobs, is but one example of the area's rapid economic expansion.[2] Aviation companies are looking to be nearby, and local campuses for Florida State University and Gulf Coast State College are expanding their engineering programs to meet expected demand. Passenger counts at Northwest Florida Beaches International Airport have nearly tripled to 910,000 since 2010. Planes are at least 80% full. A fourth national carrier will soon offer new direct flights to major cities. Recently, $1.5 billion was committed to boost the regional economy, using settlement funds from the BP oil spill. Even more appealing to prospective re-locators after the recent federal tax changes is Florida's zero state income tax. St. Joe's outlook is promising.

(2) Kleindienst, Linda. "Northwest Florida is a Hub of Aerospace and Aviation Activity". *http://www.850businessmagazine.com/June-July-2014/Northwest-Florida-is-a-Hub-of-Aerospace-and-Aviation-Activity/*. Accessed 29 January 2018.

I know the last few years have been hard. Still, the Fairholme Fund's and The Income Fund's respective after-fee performance since inception remain top-tier, as shown in exhibits following my letter. Based on our holdings, I strongly believe portfolios will return to the outperformance you richly deserve for your patience. I am reminded of Horace's quote from *Ars Poetica* found on the first page of every edition of Benjamin Graham's *Security Analysis*: "Many shall be restored that are now fallen, and many shall fall that are now in honor."

Thank you for staying the course.

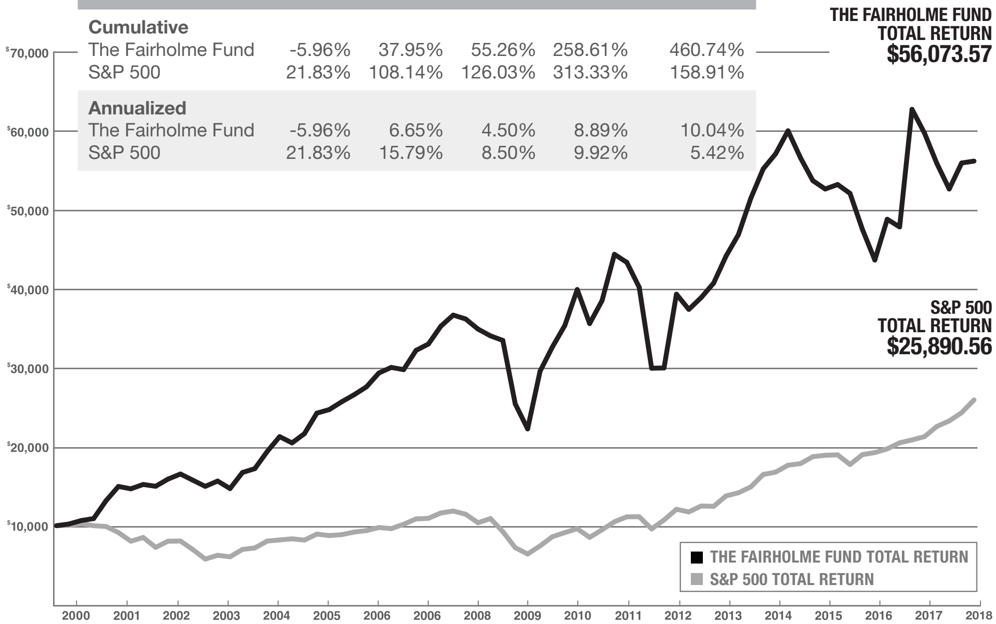
Respectfully submitted,

Bruce R. Berkowitz
Chief Investment Officer

P.S. I urge everyone to watch *Wormwood*, *The Post*, and *American Made*. These new Hollywood releases explore U.S. government cover-ups, making me realize that our fight for Fannie and Freddie is simply a repeat of history.

The Fairholme Fund

	ONE YEAR	FIVE YEARS	TEN YEARS	FIFTEEN YEARS	SINCE INCEPTION
Cumulative					
The Fairholme Fund	-5.96%	37.95%	55.26%	258.61%	460.74%
S&P 500	21.83%	108.14%	126.03%	313.33%	158.91%
Annualized					
The Fairholme Fund	-5.96%	6.65%	4.50%	8.89%	10.04%
S&P 500	21.83%	15.79%	8.50%	9.92%	5.42%



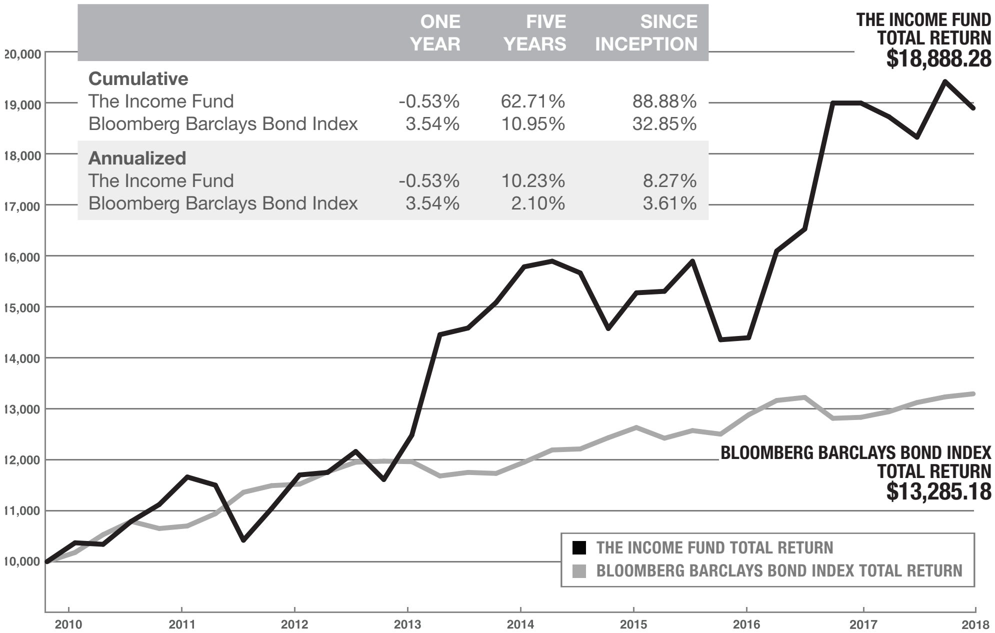
TOP ISSUERS (% OF NET ASSETS)	
Cash and Cash Equivalents*	27.1%
The St. Joe Co.	21.7%
Federal Home Loan Mortgage Corp.	15.7%
Federal National Mortgage Association	14.8%
Imperial Metals Corp.	8.1%
Sears Holdings Corp.	6.6%
Seritage Growth Properties	4.7%
International Wire Group, Inc.	2.0%
Monitronics International, Inc.	1.8%

The chart on the left covers the period from inception of The Fairholme Fund (December 29, 1999) through December 31, 2017.

The Fairholme Fund decreased 5.96% versus a 21.83% gain for the S&P 500 in 2017. At year-end, and since inception, The Fairholme Fund increased 460.74% versus 158.91% for the S&P 500. 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, 2017. The value of a $10,000 investment in The Fairholme Fund at its inception was worth $56,073.57 (assumes reinvestment of distributions into additional Fairholme Fund shares) compared to $25,890.56 for the S&P 500 at year-end. Of the $56,073.57, the value of reinvested distributions was $35,933.57.

The Income Fund

	ONE YEAR	FIVE YEARS	SINCE INCEPTION
Cumulative			
The Income Fund	-0.53%	62.71%	88.88%
Bloomberg Barclays Bond Index	3.54%	10.95%	32.85%
Annualized			
The Income Fund	-0.53%	10.23%	8.27%
Bloomberg Barclays Bond Index	3.54%	2.10%	3.61%



TOP ISSUERS (% OF NET ASSETS)	
Cash and Cash Equivalents*	45.5%
Imperial Metals Corp.	10.2%
Seritage Growth Properties	9.0%
Sears Holdings Corp.	6.8%
Federal National Mortgage Association	5.7%
Federal Home Loan Mortgage Corp.	5.3%
International Wire Group, Inc.	4.5%
GMAC Capital Trust I, Inc.	2.7%
HC2 Holdings, Inc.	2.6%
Public Finance Authority	2.2%

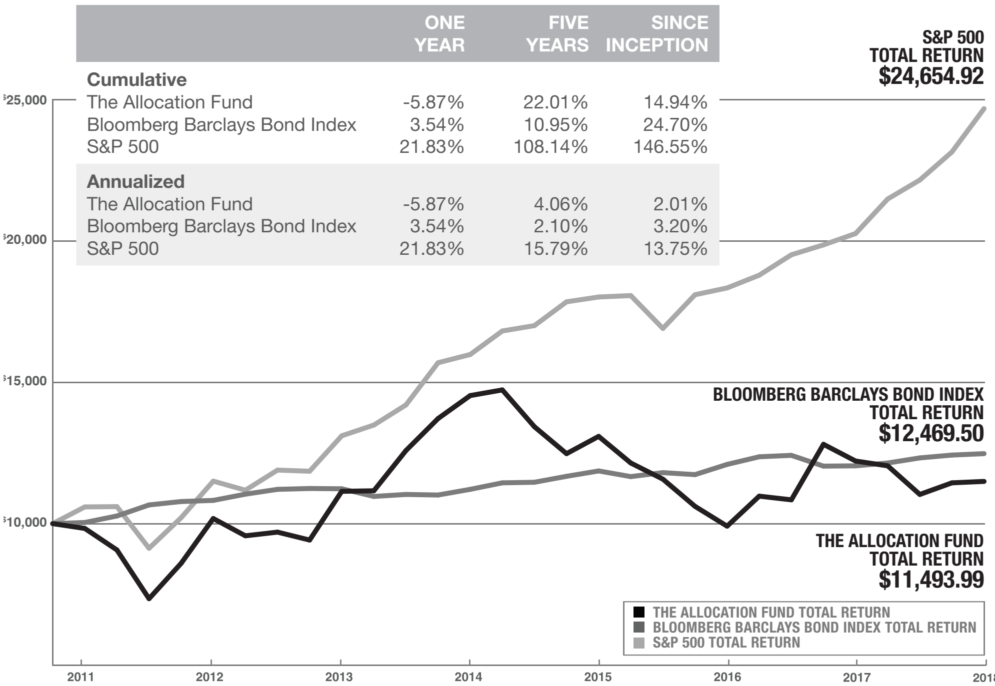
The Income Fund's 30-Day SEC Yield at December 31, 2017, was 4.25%.
The chart on the left covers the period from inception of The Income Fund (December 31, 2009) through December 31, 2017.

The Income Fund decreased 0.53% versus a 3.54% gain for the Bloomberg Barclays Bond Index in 2017. At year-end, and since inception, The Income Fund increased 88.88% versus 32.85% for the Bloomberg Barclays Bond Index. The above graph and performance table compare The Income Fund's unaudited performance (after expenses) with that of the Bloomberg Barclays Bond Index, with dividends and distributions reinvested, for various periods ending December 31, 2017. The value of a $10,000 investment in The Income Fund at its inception was worth $18,888.28 (assumes reinvestment of distributions into additional Income Fund shares) compared to $13,285.18 for the Bloomberg Barclays Bond Index at year-end. Of the $18,888.28, the value of reinvested distributions was $7,868.28.

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

The Allocation Fund

	ONE YEAR	FIVE YEARS	SINCE INCEPTION
Cumulative			
The Allocation Fund	-5.87%	22.01%	14.94%
Bloomberg Barclays Bond Index	3.54%	10.95%	24.70%
S&P 500	21.83%	108.14%	146.55%
Annualized			
The Allocation Fund	-5.87%	4.06%	2.01%
Bloomberg Barclays Bond Index	3.54%	2.10%	3.20%
S&P 500	21.83%	15.79%	13.75%



TOP ISSUERS (% OF NET ASSETS)	
Cash and Cash Equivalents*	28.1%
Seritage Growth Properties	17.6%
Federal Home Loan Mortgage Corp.	17.3%
Federal National Mortgage Association	11.8%
The St. Joe Co.	6.3%
Imperial Metals Corp.	6.1%
Sears Holdings Corp.	4.3%
International Wire Group, Inc.	3.9%
Chesapeake Energy Corp.	2.4%
Monitronics International, Inc.	2.0%

The Allocation Fund's 30-Day SEC Yield at December 31, 2017, was 0.93%.

The chart on the left covers the period from inception of The Allocation Fund (December 31, 2010) through December 31, 2017.

The Allocation Fund decreased 5.87% versus a 3.54% gain for the Bloomberg Barclays Bond Index and a 21.83% increase for the S&P 500 in 2017. At year-end, and since inception, The Allocation Fund increased 14.94% versus 24.70% and 146.55% for the Bloomberg Barclays Bond Index and the S&P 500, respectively. 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, 2017. The value of a $10,000 investment in The Allocation Fund at its inception was worth $11,493.99 (assumes reinvestment of distributions into additional Allocation Fund shares) compared to $12,469.50 and $24,654.92 for the Bloomberg Barclays Bond Index and the S&P 500, respectively, at year-end. Of the $11,493.99, the value of reinvested distributions was $3,513.99.

The Funds' investment objectives, risks, charges, and expenses should be considered carefully before investing. The prospectus contains this and other important information about the Funds, 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. The Portfolio Manager's Report and corresponding Appendix are 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 and corresponding Appendix are 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.

Fairholme Distributors, LLC (1/18)

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