

FAIRHOLME
Ignore the crowd.

FOCIX 2014

“(E)ven the intelligent investor is likely to need considerable willpower to keep from following the crowd.”

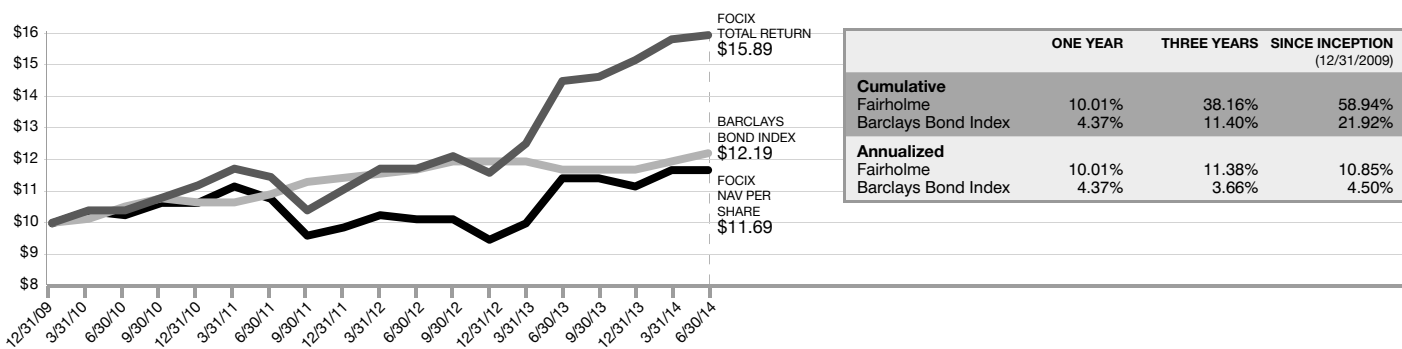
Benjamin Graham

Mutual fund investing involves risks, including loss of principal. The chart below covers the period from inception of The Fairholme Focused Income Fund (December 31, 2009) to June 30, 2014. Past performance information quoted below does not guarantee future results. The investment return and principal value of an investment in The Fairholme Focused Income Fund will fluctuate so that 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 assume reinvestment of dividends and capital gains. Most recent month-end performance and answers to any questions you may have can be obtained by calling Shareholder Services at 1.866.202.2263. The Fairholme Focused Income Fund maintains a focused portfolio of investments in a limited number of issuers and does not seek to diversify its investments. This exposes The Fairholme Focused Income Fund to the risk of unanticipated industry conditions and risks particular to a single company or the securities of a single company. The Fairholme Focused Income Fund's performance may differ markedly from the performance of the Barclays Capital U.S. Aggregate Bond Index in either up or down market trends. The Barclays Capital U.S. Aggregate Bond Index is an unmanaged market-weighted index comprised of investment-grade (rated Baa3/BBB-/BBB- or higher) taxable bonds, mortgage-backed securities, asset-backed securities, corporate securities, and government-related securities, including U.S. Treasury and government agency issues, with at least one year to maturity. Because indices cannot be invested in directly, these index returns do not reflect a deduction for fees, expenses, or taxes. The Fairholme Focused Income Fund's expense ratio reflected in its prospectus dated March 28, 2014, is 1.01%, which included acquired fund fees and expenses that are incurred indirectly by The Fairholme Focused Income Fund as a result of investments in securities issued by one or more investment companies. Effective as of the close of business on February 28, 2013, the sale of shares of The Fairholme Focused Income Fund has been suspended to new investors, subject to certain exceptions.

July 29, 2014

To the Shareholders and Directors of The Fairholme Focused Income Fund:

The Fairholme Focused Income Fund (the "Fund" or "FOCIX" or "Fairholme") increased 5.39%, versus an increase of 3.93% for the Barclays Capital U.S. Aggregate Bond Index (the "Barclays Bond Index"), for the six-month period that ended June 30, 2014. Since inception, the Fund increased 58.94% versus 21.92% for the Barclays Bond Index. The following table compares the Fund's unaudited performance (after expenses) with that of the Barclays Bond Index, with dividends and distributions reinvested, for the period that ended June 30, 2014.



At June 30, 2014, the Fund is composed of U.S. Treasury Bills, money market funds, and cash (47%), Sears corporate bonds maturing in 2018 (25%), preferred stocks of Fannie Mae and Freddie Mac (15%), preferred stock of Bank of America (4%), and a group of common stocks yielding between 4% and 8% (each a 1% position and, in total, 9%). The Fund's current yield is 2.6% and increasing. Liquidity and yield will continue to be a focus as we finish our fifth year at the end of 2014.

Respectfully submitted,

Bruce R. Berkowitz
Managing Member
Fairholme Capital Management

The Portfolio Manager's Report is not part of The Fairholme Focused Income Fund's Semi-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 and precedes a more formal Management Discussion and Analysis. Opinions of the Portfolio Manager are intended as such, and not as statements of fact requiring attestation. All references to portfolio investments of The Fairholme Focused Income Fund are as of the latest public filing of The Fairholme Focused Income Fund with respect to such holdings at the time of publication, unless specified.

*“Traditionally the investor has been the man with patience
and the courage of his convictions who would buy when the
harried or disheartened speculator was selling.”*

Benjamin Graham & David Dodd

FAIRHOLME
Ignore the crowd.

The Fairholme Focused Income Fund (FOCIX)
Seeking current income

Semi-Annual Report 2014

Managed by Fairholme Capital Management

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THE FAIRHOLME FOCUSED INCOME FUND

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May 31, 2014

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THE FAIRHOLME FOCUSED INCOME FUND

FUND PERFORMANCE (unaudited)
Inception through May 31, 2014



The Fairholme Focused Income Fund (the “Fund”) commenced operations on December 31, 2009. The chart above presents the performance of a \$25,000 investment from inception to the latest semi-annual period ended May 31, 2014.

The following notes pertain to the chart above as well as to the performance table included in the Management Discussion & Analysis Report. **Performance information in this report represents past performance and is not a guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate, so that 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 quoted within. The performance information does not reflect the taxes an investor would pay on Fund distributions or upon redemption of Fund shares. Most recent month-end performance and answers to any questions you may have can be obtained by calling Shareholder Services at 1-866-202-2263.**

Data for both the Barclays Capital U.S. Aggregate Bond Index and the Fund are presented assuming all dividends and distributions have been reinvested and do not reflect any taxes that might have been incurred by a shareholder as a result of the Fund distributions. The Barclays Capital U.S. Aggregate Bond Index is an unmanaged market weighted index comprised of investment grade corporate bonds (rated BBB or better), mortgages, and U.S. Treasury and government agency issues with at least one year to maturity and does not reflect any investment management fees or transaction expenses, nor the effects of taxes, fees, or other charges.

THE FAIRHOLME FOCUSED INCOME FUND

MANAGEMENT DISCUSSION & ANALYSIS For the Six Months Ended May 31, 2014

The Fairholme Focused Income Fund (the “Fund”) shares outstanding and unaudited net asset value per share (“NAV”) at May 31, 2014, the end of the Fund’s second fiscal quarter of 2014, and per share NAVs at other pertinent dates, were as follows:

<u>05/31/2014</u> Shares <u>Outstanding</u>	<u>05/31/2014</u> NAV <u>(unaudited)</u>	<u>11/30/2013</u> NAV <u>(audited)</u>	<u>05/31/2013</u> NAV <u>(unaudited)</u>
20,470,343	\$11.72	\$11.98	\$11.89

At June 30, 2014, the unaudited per share NAV of the Fund was \$11.69. Performance figures below are shown for the Fund’s semi-annual period ended May 31, 2014, and do not match calendar year figures for the period ended June 30, 2014, cited in the Portfolio Manager’s report.

<u>Fund Performance</u> <u>to 05/31/2014</u>	<u>Six</u> <u>Months</u>	<u>One</u> <u>Year</u>	<u>Since</u> <u>Inception</u> <u>12/31/2009</u>
Cumulative:			
Fund	4.47%	7.62%	58.71%
Barclays Bond Index	3.29%	2.71%	21.86%
Annualized:			
Fund		7.62%	11.03%
Barclays Bond Index		2.71%	4.58%

For the six months ended May 31, 2014, the Fund outperformed the Barclays Capital U.S. Aggregate Bond Index (“Barclays Bond Index”) by 1.18 percentage points while over the last year the Fund outperformed the Barclays Bond Index by 4.91 percentage points. From inception, the Fund outperformed the Barclays Bond Index by 6.45 percentage points per annum, or on a cumulative basis, 36.85 percentage points over four years and five months.

Fairholme Capital Management, L.L.C. (the “Manager”) believes performance over shorter periods is likely to be less meaningful than performance over longer periods. Investors are cautioned not to rely on short-term results. The fact that securities increase or decline in value does not always indicate that the Manager believes these securities to be more or less attractive — in fact, the Manager believes that some price increases present selling opportunities and some price declines present buying opportunities.

Further, shareholders should note that the Barclays Bond Index is an unmanaged index incurring no fees, expenses, or tax effects and is shown solely to compare Fund performance to that of an unmanaged and diversified index.

Shareholders are also cautioned that it is possible that some securities mentioned in this discussion may no longer be held by the Fund subsequent to the end of the fiscal period and that the Fund may have made significant new purchases that are not yet required to be disclosed. It is the Fund’s general policy not to disclose portfolio holdings other than when required by relevant law or regulation. Portfolio holdings are subject to change without notice.

Not all Fund portfolio dispositions or additions are material, and, while the Fund and the Manager have long-term objectives, it is possible that a security sold or purchased in one period will be purchased or sold in a subsequent period. Generally, the Manager determines to buy and sell based on its estimates of the absolute and relative intrinsic values and fundamental dynamics of a particular security and its issuer and its industry. However, certain strategies of the Manager in carrying out Fund policies may result in shorter holding periods.

The Manager invests Fund assets in securities to the extent it finds reasonable investment opportunities in accordance with its Prospectus and may invest a significant portion of Fund assets in liquid, low-risk securities or cash. The Manager views liquidity as a strategic advantage. At May 31, 2014, cash and cash equivalents (consisting of cash, commercial paper, deposit accounts, U.S. Treasury Bills, and money-market funds) represented 49.49% of total assets. Since inception, the Fund has held liquid, low-risk securities or cash for periods without negatively influencing performance, although there is no guarantee that future performance will not be negatively affected by Fund liquidity.

THE FAIRHOLME FOCUSED INCOME FUND

MANAGEMENT DISCUSSION & ANALYSIS (continued)

For the Six Months Ended May 31, 2014

The Fund is considered to be “non-diversified” under the Investment Company Act of 1940. The Fund can invest a greater percentage of assets in fewer securities than a diversified fund and may invest a significant portion of cash and liquid assets in one or more higher risk securities at any time, particularly in situations where markets are weak or a particular security declines sharply. The Fund may also have a greater percentage of assets invested in a particular industry than a diversified fund, exposing the Fund to the risk of an unanticipated industry condition as well as risks specific to a single company or security. For the six months ended May 31, 2014, significant contributions to the Fund’s performance came from the Fund’s investments in securities of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corp. The following charts show the top holdings by issuer and sector in descending order of net assets as of May 31, 2014.

The Fairholme Focused Income Fund Top Holdings by Issuer* (% of Net Assets)		The Fairholme Focused Income Fund Top Sectors** (% of Net Assets)	
Sears Holdings Corp.	24.8%	Cash and Cash Equivalents***	49.6%
Federal National Mortgage Association	9.0%	Retail Department Stores	24.8%
Federal Home Loan Mortgage Corp.	6.3%	Mortgage Finance	15.3%
Bank of America Corp.	3.5%	Diversified Banks	3.5%
Mercury General Corp.	1.1%	Property & Casualty Insurance	1.1%
Vodafone Group plc, ADR	1.0%	Wireless Telecommunication Services	1.0%
AT&T, Inc.	1.0%	Diversified Telecommunications	1.0%
	<u>46.7%</u>		<u>96.3%</u>

*Excludes cash, U.S. Treasury Bills, miscellaneous investments, and money market funds.

**Excludes miscellaneous investments.

***Includes cash, U.S. Treasury Bills, and money market funds.

The Manager views the ability to focus on fewer investments than a diversified fund as a strategic advantage. However, such a strategy may negatively influence short-term performance and there is no guarantee that long-term performance will not be negatively affected.

The Fund may invest in non-U.S. securities and securities of corporations domiciled outside of the United States, which may expose the Fund to adverse changes resulting from foreign currency fluctuations or other potential risks as described in the Fund’s Prospectus and Statement of Additional Information.

The Fund’s officers, the Board of Directors (the “Board” or the “Directors”), and the Manager are aware that large cash inflows or outflows may adversely affect Fund performance. Such flows are monitored and appropriate actions are contemplated for when such flows could negatively impact performance.

Since inception, the Fund has been advised by the Manager. Bruce Berkowitz, both the Managing Member of the Manager and Chairman of the Fund’s Board, continues to have a significant personal stake in the Fund, holding an aggregate 828,406 shares at May 31, 2014. While there is no requirement that Mr. Berkowitz own shares of the Fund, such holdings are believed to help align shareholder interests.

The Board, including the Independent Directors, continues to believe that it is in the best interests of Fund to have Mr. Berkowitz serve as Chairman of the Board given: his long-term relative performance; his experience, commitment, and significant personal investment in the Funds; the present constitution of Directors and policies; and current rules and regulations. A Director and Officers of the Fund are also Officers of the Manager. Nevertheless, at May 31, 2014, a majority of Directors were independent of the Manager, no stock option or restricted stock plans exist, Officers received no direct compensation from the Fund, and the Director affiliated with the Manager received no compensation for being a Director.

For more complete information about the Fund, or to obtain a current Prospectus, please visit www.fairholmefunds.com or call Shareholder Services at 1-866-202-2263.

THE FAIRHOLME FOCUSED INCOME FUND

EXPENSE EXAMPLE

For the Six Month Period from December 1, 2013
through May 31, 2014 (unaudited)

As a Fund shareholder, you incur direct and indirect costs. Direct costs include, but are not limited to, transaction fees at some broker-dealers, custodial fees for retirement accounts and wire transfer fees. You also incur indirect, ongoing costs that include, but are not limited to, management fees paid to the Manager.

The following example is intended to help you understand your indirect costs (also referred to as “ongoing costs” and measured in dollars) when investing in the Fund and to compare these costs with the ongoing costs of investing in other mutual funds. This example is based on an investment of \$1,000 invested in the Fund at December 1, 2013, and held for the entire six month period ending May 31, 2014.

Actual Expenses

The first line of the table below provides information about actual account values and actual expenses. You may use the information in this line, together with the amount you had invested at the beginning of the period, to estimate the expenses that you paid over the period. Simply divide your account value by \$1,000 (for example, an \$8,600 account value divided by \$1,000 = 8.6), then multiply the result by the number in the first line under the heading “Expenses Paid During the Period” to estimate the expenses you paid on your Fund holdings during this period.

Hypothetical Example for Comparison Purposes

The second line of the table provides information about hypothetical account values and hypothetical expenses based on the Fund’s actual expense ratio and an assumed rate of return of 5% per year before expenses, which is not the Fund’s actual return for the period presented. The hypothetical account values and expenses may not be used to estimate the actual ending account balance or expenses that you paid for the period presented. However, you may use this information to compare ongoing costs of investing in the Fund with the ongoing costs of investing in other funds. To do so, compare this 5% hypothetical example with the 5% examples that appear in the shareholder reports of other funds.

Please note that the column titled “Expenses Paid During the Period” in the table below is meant to highlight your ongoing costs only and do not reflect any transactional costs, such as redemption fees (if any), or other direct costs. Therefore, the second line of the table is useful in comparing ongoing costs only, and will not help you determine the relative total costs of owning different funds. In addition, if these direct costs were included, your total costs would be higher.

Fund	Beginning Account Value December 1, 2013	Ending Account Value May 31, 2014	Annualized Expense Ratio	Expenses Paid During the Period December 1, 2013 Through May 31, 2014*
Actual	\$1,000.00	\$1,044.70	1.00%	\$5.10
Hypothetical (5% return before expenses)	\$1,000.00	\$1,019.95	1.00%	\$5.04

* Expenses are equal to the Fund’s annualized expense ratio, multiplied by the average account value over the period, multiplied by 182 days/365 days (to reflect the one-half year period).

THE FAIRHOLME FOCUSED INCOME FUND

SCHEDULE OF INVESTMENTS
May 31, 2014 (unaudited)

<u>Shares</u>	<u>Value</u>	<u>Principal</u>	<u>Value</u>
DOMESTIC EQUITY SECURITIES — 3.1%		DOMESTIC CORPORATE BONDS — 24.8%	
DIVERSIFIED TELECOMMUNICATIONS — 1.0%		RETAIL DEPARTMENT STORES — 24.8%	
68,500	\$ 2,429,695	\$64,574,000	Sears Holdings Corp. 6.625%, 10/15/2018
			\$ 59,408,080
PROPERTY & CASUALTY INSURANCE — 1.1%		TOTAL DOMESTIC CORPORATE BONDS (COST \$62,461,203)	
53,600	2,527,240		59,408,080
WIRELESS TELECOMMUNICATION SERVICES — 1.0%		U.S. GOVERNMENT OBLIGATIONS — 37.5%	
71,000	2,485,710	10,000,000	U.S. Treasury Bills 0.094%, 09/18/2014 ^(c)
TOTAL DOMESTIC EQUITY SECURITIES (COST \$7,453,010)		35,000,000	U.S. Treasury Bills 0.096%, 10/16/2014 ^(c)
	7,442,645	10,000,000	U.S. Treasury Bills 0.118%, 11/13/2014 ^(c)
DOMESTIC PREFERRED EQUITY SECURITIES — 18.8%		35,000,000	U.S. Treasury Bills 0.107%, 04/30/2015 ^(c)
DIVERSIFIED BANKS — 3.5%		TOTAL U.S. GOVERNMENT OBLIGATIONS (COST \$89,952,539)	
312,500	6,712,500	<u>Shares</u>	89,966,430
79,100	1,744,155	MONEY MARKET FUNDS — 12.1%	
	8,456,655	28,900,342	Fidelity Institutional Money Market Funds - Money Market Portfolio, 0.090% ^(d)
MORTGAGE FINANCE — 15.3%		TOTAL MONEY MARKET FUNDS (COST \$28,900,342)	
1,629,724	15,107,541		28,900,342
1,167,500	21,598,750	MISCELLANEOUS INVESTMENTS — 3.5% ^(e)	
	36,706,291	(COST \$8,021,846)	
TOTAL DOMESTIC PREFERRED EQUITY SECURITIES (COST \$25,042,921)		TOTAL INVESTMENTS — 99.8% (COST \$221,831,861)	
	45,162,946		
		OTHER ASSETS IN EXCESS OF LIABILITIES — 0.2%	
		NET ASSETS — 100.0%	
		\$ 239,949,257	

^(a) Non-income producing security.

^(b) Variable rate security. Rate shown is the effective rate as of May 31, 2014.

^(c) Rates shown are the effective yields based on the purchase price. The calculation assumes the security is held to maturity.

^(d) Annualized based on the 1-day yield as of May 31, 2014.

^(e) Represents previously undisclosed unrestricted securities, which the Fund has held for less than one year.

The accompanying notes are an integral part of the financial statements.

THE FAIRHOLME FOCUSED INCOME FUND

STATEMENT OF ASSETS & LIABILITIES
May 31, 2014 (unaudited)

Assets

Investments, at Fair Value (Cost — \$221,831,861)	\$239,349,457
Dividends and Interest Receivable	593,165
Receivable for Capital Shares Sold	220,000
Total Assets	<u>240,162,622</u>

Liabilities

Accrued Management Fees	203,987
Payable for Capital Shares Redeemed	9,378
Total Liabilities	<u>213,365</u>

NET ASSETS

\$239,949,257

Net Assets Consist of:

Paid-In Capital	\$222,561,169
Accumulated Undistributed Net Investment Income	599,163
Net Accumulated Realized Loss on Investments	(728,671)
Net Unrealized Appreciation on Investments	17,517,596

NET ASSETS

\$239,949,257

Shares of Common Stock Outstanding* (\$0.0001 par value) 20,470,343

Net Asset Value, Offering and Redemption Price Per Share
(\$239,949,257 / 20,470,343 shares) \$ 11.72

* 200,000,000 shares authorized in total.

The accompanying notes are an integral part of the financial statements.

THE FAIRHOLME FOCUSED INCOME FUND

STATEMENT OF OPERATIONS (unaudited)

	For the Six Months Ended May 31, 2014
Investment Income	
Interest	\$ 2,545,174
Dividends	<u>213,222</u>
Total Investment Income	<u>2,758,396</u>
Expenses	
Management Fees	<u>1,197,120</u>
Total Expenses	<u>1,197,120</u>
Net Investment Income	<u>1,561,276</u>
Realized and Unrealized Gain (Loss) on Investments	
Net Realized Loss on Investments	(728,586)
Net Change in Unrealized Appreciation on Investments	<u>9,368,677</u>
Net Realized and Unrealized Gain (Loss) on Investments	<u>8,640,091</u>
NET INCREASE IN NET ASSETS FROM OPERATIONS	<u><u>\$10,201,367</u></u>

The accompanying notes are an integral part of the financial statements.

THE FAIRHOLME FOCUSED INCOME FUND

STATEMENTS OF CHANGES IN NET ASSETS

	<u>For the Six Months Ended May 31, 2014 (unaudited)</u>	<u>For the Fiscal Year Ended November 30, 2013</u>
CHANGES IN NET ASSETS		
From Operations		
Net Investment Income	\$ 1,561,276	\$ 10,576,270
Net Realized Gain (Loss) on Investments	(728,586)	23,074,399
Net Change in Unrealized Appreciation on Investments	<u>9,368,677</u>	<u>25,139,412</u>
Net Increase in Net Assets from Operations	<u>10,201,367</u>	<u>58,790,081</u>
From Dividends and Distributions to Shareholders		
Net Investment Income	(1,644,215)	(14,560,171)
Net Realized Capital Gains from Investment Transactions	<u>(13,876,149)</u>	<u>—</u>
Net Decrease in Net Assets from Dividends and Distributions	<u>(15,520,364)</u>	<u>(14,560,171)</u>
From Capital Share Transactions		
Proceeds from Sale of Shares	15,013,649	28,234,083
Shares Issued in Reinvestment of Dividends and Distributions	13,121,290	12,435,924
Cost of Shares Redeemed	<u>(29,854,589)</u>	<u>(95,341,938)</u>
Net Decrease in Net Assets from Shareholder Activity	<u>(1,719,650)</u>	<u>(54,671,931)</u>
NET ASSETS		
Net Decrease in Net Assets	(7,038,647)	(10,442,021)
Net Assets at Beginning of Period	<u>246,987,904</u>	<u>257,429,925</u>
Net Assets at End of Period	<u>\$239,949,257</u>	<u>\$246,987,904</u>
Accumulated Undistributed Net Investment Income at End of Period	<u>\$ 599,163</u>	<u>\$ 682,102</u>
SHARES TRANSACTIONS		
Issued	1,296,582	2,718,394
Reinvested	1,170,547	1,214,865
Redeemed	<u>(2,605,502)</u>	<u>(9,017,977)</u>
Net Decrease in Shares	(138,373)	(5,084,718)
Shares Outstanding at Beginning of Period	<u>20,608,716</u>	<u>25,693,434</u>
Shares Outstanding at End of Period	<u>20,470,343</u>	<u>20,608,716</u>

The accompanying notes are an integral part of the financial statements.

THE FAIRHOLME FOCUSED INCOME FUND

FINANCIAL HIGHLIGHTS

	For the Six Months Ended May 31, 2014 (unaudited)	For the Fiscal Year Ended November 30, 2013	For the Fiscal Year Ended November 30, 2012	For the Fiscal Year Ended November 30, 2011	For the Period Ended November 30, 2010 ⁽¹⁾
PER SHARE OPERATING PERFORMANCE					
NET ASSET VALUE, BEGINNING OF PERIOD	\$11.98	\$10.02	\$9.71	\$10.70	\$10.00
Investment Operations					
Net Investment Income ⁽²⁾	0.08	0.46	0.97	0.64	0.45
Net Realized and Unrealized Gain (Loss) on Investments	0.42	2.12	0.31	(0.95)	0.45
Total from Investment Operations	0.50	2.58	1.28	(0.31)	0.90
Dividends and Distributions					
From Net Investment Income	(0.08)	(0.62)	(0.97)	(0.64)	(0.20)
From Realized Capital Gains	(0.68)	—	—	(0.04)	—
Total Dividends and Distributions	(0.76)	(0.62)	(0.97)	(0.68)	(0.20)
NET ASSET VALUE, END OF PERIOD	\$11.72	\$11.98	\$10.02	\$9.71	\$10.70
TOTAL RETURN	4.47% ⁽³⁾	26.91%	13.45%	(3.24)%	9.05% ⁽³⁾
Ratio/Supplemental Data					
Net Assets, End of Period (in 000's)	\$239,949	\$246,988	\$257,430	\$299,224	\$364,235
Ratio of Expenses to Average Net Assets:					
Before Expenses Waived	1.00% ⁽⁴⁾	1.00%	1.00%	1.00%	1.00% ⁽⁴⁾
After Expenses Waived	— ⁽⁵⁾	— ⁽⁵⁾	0.91%	0.67%	0.50% ⁽⁴⁾
Ratio of Net Investment Income to Average Net Assets	1.30% ⁽⁴⁾	4.28%	9.53%	5.96%	4.69% ⁽⁴⁾
Portfolio Turnover Rate	9.65% ⁽³⁾	42.87%	8.27%	91.67%	77.03% ⁽³⁾

⁽¹⁾ The Fund commenced operations on December 31, 2009.

⁽²⁾ Based on average shares outstanding.

⁽³⁾ Not Annualized.

⁽⁴⁾ Annualized.

⁽⁵⁾ Effective March 29, 2012, the Manager's contractual management fee waiver/expense reimbursement for the Fund expired.

The accompanying notes are an integral part of the financial statements.

THE FAIRHOLME FOCUSED INCOME FUND

NOTES TO FINANCIAL STATEMENTS
May 31, 2014 (unaudited)

Note 1. Organization

Fairholme Funds, Inc. (the “Company”), a Maryland corporation, is registered under the Investment Company Act of 1940, as amended (the “1940 Act”), as an open-end management investment company. The Company’s Articles of Incorporation permit the Board of Directors of the Company (the “Board” or the “Directors”) to issue 1,100,000,000 shares of common stock at \$.0001 par value. 200,000,000 shares have been allocated to The Fairholme Focused Income Fund (the “Fund”). The Fund is a non-diversified fund. The Fund may have a greater percentage of its assets invested in particular securities than a diversified fund, exposing the Fund to the risk of unanticipated industry conditions as well as risks specific to a single company or the securities of a single company. The Board has the power to designate one or more separate and distinct series and/or classes of shares of common stock and to classify or reclassify any unissued shares with respect to such series.

The Fund’s investment objective is to seek current income. Under normal circumstances, the Fund seeks to achieve its investment objective by investing in a focused portfolio of cash distributing securities. To maintain maximum flexibility, the securities in which the Fund may invest include corporate debt securities of issuers in the U.S. and foreign countries, bank debt (including bank loans and loan participations), government and agency debt securities of the U.S. and foreign countries, convertible bonds and other convertible securities and equity securities, including preferred and common stock and interests in real estate investment trusts (“REITs”). Although the Fund normally holds a focused portfolio of securities, the Fund is not required to be fully invested in such securities and may maintain a significant portion of its total assets in cash and securities generally considered to be cash equivalents. Fairholme Capital Management, L.L.C. (the “Manager”) serves as investment adviser to the Fund.

There is no guarantee that the Fund will meet its objectives.

As of March 1, 2013, (the “Closing Date”), the sale of shares of the Fund has been suspended to new investors, subject to certain exceptions as described below. Subject to the right of the Fund to reject any order to purchase shares or to withdraw the offering of shares at any time, shares remain available for purchase to existing Fund shareholders. The following categories of new investors may continue to purchase shares of the Fund: (i) clients of financial advisors and financial consultants that have clients invested in the Fund as of the Closing Date; (ii) clients of financial advisors and intermediaries that have approved the inclusion of the Fund as an investment option in their asset allocation programs or discretionary investment programs, including wrap, model or other managed account programs, as of the Closing Date; and (iii) participants in group retirement plans that include the Fund as an investment option as of the Closing Date, and IRA transfers and rollovers from such plans. In addition, Directors of the Company, clients and employees of the Manager and their respective immediate family members may open new accounts and add shares of the Fund to such accounts. The Fund retains the right to limit the foregoing exceptions, make additional exceptions to the suspension of the sale of the Fund’s shares to new investors, and subsequently commence selling its shares to new investors.

Note 2. Significant Accounting Policies

The Fund’s investments are reported at fair value as defined by Accounting Principles Generally Accepted in the United States of America (“U.S. GAAP”). The Fund calculates its net asset value as soon as practicable following the close of regular trading on the New York Stock Exchange (currently 4:00 p.m. Eastern Time) on each day the New York Stock Exchange is open.

A description of the valuation techniques applied to the Fund’s securities measured at fair value on a recurring basis follows:

Security Valuation:

Equity securities (common and preferred stocks): Securities traded on a national securities exchange or reported on the NASDAQ national market are generally valued at the official closing price, or at the last reported sale price on the exchange or market on which the securities are traded, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available bid price. To the extent these securities are actively traded and valuation adjustments are not applied, they are classified in Level 1 of the fair value hierarchy. If these securities are not actively traded, they are classified

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May 31, 2014 (unaudited)

in Level 2. The Manager may also employ other valuation methods which the Manager believes would provide a more accurate indication of fair value. In these situations, if the inputs are observable, the valuation will be classified in Level 2 of the fair value hierarchy, otherwise they would be classified in Level 3.

Fixed-income securities (U.S. government obligations, corporate bonds, convertible bonds, and asset backed securities): The fair value of fixed-income securities is estimated using market quotations when readily available, but may also be estimated by various methods when no such market quotations exist and when the Manager believes these other methods reflect the fair value of such securities. These methods may consider recently executed transactions in securities of the issuer or comparable issuers and market price valuations from independent pricing services and/or brokers (where observable). Where the Manager deems it appropriate to do so (such as when independent prices are unavailable or not deemed to be representative of fair value) fixed-income securities will be fair valued in good faith following consideration by, and conclusion of, the Manager's Valuation Committee. As of May 31, 2014, fixed-income securities are valued by the Manager utilizing observable market prices on the day of valuation or the average bid of independent broker/dealer quotes and/or the average of valuations from independent pricing services. Although fixed-income securities are classified in Level 2 of the fair value hierarchy at May 31, 2014, in instances where lower relative weight is placed on transaction prices, quotations, or similar observable inputs, they would be classified in Level 3.

Open-end mutual funds: Investments in open-end mutual funds including money market funds are valued at their closing net asset value each business day and are classified in Level 1 of the fair value hierarchy.

Short-term securities: Investments in securities with maturities of less than sixty days when acquired or long-term securities, which are within sixty days of maturity are estimated by using the amortized cost method of valuation, which the Manager and the Board have determined will approximate fair value. To the extent the inputs are observable and timely, the values would be classified in Level 2 of the fair value hierarchy.

Restricted securities: Depending on the relative significance of valuation inputs, these instruments may be classified in any level of the fair value hierarchy.

Warrants: The Fund may invest in warrants, which may be acquired either through a direct purchase, included as part of a private placement, or pursuant to corporate actions. Warrants entitle, but do not obligate, the holder to buy equity securities at a specific price for a specific period of time. Warrants may be considered more speculative than certain other types of investments in that they do not entitle a holder to dividends or voting rights with respect to the underlying securities that may be purchased nor do they represent any rights in the assets of the issuing company. Also, the value of a warrant does not necessarily change with the value of the underlying securities and a warrant ceases to have value if it is not exercised prior to its expiration date. Warrants traded on a security exchange are valued at the official closing price on the valuation date and are classified as Level 1 of the fair value hierarchy. Over the counter (OTC) warrants are valued using simulation models utilizing market value of the underlying security, expiration date of the warrants, volatility of the underlying security, strike price of the warrants, risk-free interest rate at the valuation date, and are classified as Level 2 or Level 3 of the fair value hierarchy depending on the observability of the inputs used.

The Fund uses several recognized industry third-party pricing services (TPPS) - approved by the Board and unaffiliated with the Manager - to value some of its securities. It also uses other independent market trade data sources (such as TRACE, the FINRA-developed mandatory reporting of over-the-counter secondary market transactions), as well as broker quotes provided by market makers. The data within these feeds is ultimately sourced from major stock exchanges and trading systems where these securities trade. If a price obtained from the pricing source is deemed unreliable, it may be discarded and/or challenged. In these cases the pricing decision is made by reference to the reliable market data from the other market data sources.

The Manager may determine the fair valuation of a security when market quotations are insufficient or not readily available, when securities are determined to be illiquid or restricted, or when in the judgment of the Manager the prices or values available do not represent the fair value of the instrument. Factors which may cause the Manager to make such a judgment

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NOTES TO FINANCIAL STATEMENTS (continued)
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include the following: (a) only a bid price or an asked price is available; (b) the spread between bid and asked prices is substantial; (c) the liquidity of the securities; (d) the frequency of sales; (e) the thinness of the market; (f) the size of reported trades; (g) actions of the securities markets, such as the suspension or limitation of trading; and (h) bona fide bids or offers made to the Manager by independent third parties. Among the factors to be considered to fair value a security are recent prices of comparable securities that are publicly traded, reliable prices of securities not publicly traded, the use of valuation models, current analyst reports, valuing the income or cash flow of the issuer, or cost if the preceding factors do not apply. The circumstances of Level 3 securities are frequently monitored to determine if fair valuation measures continue to apply.

The Manager reports quarterly to the Board the results of the application of fair valuation policies and procedures.

The inputs and valuation techniques used to measure fair value of the Fund's investments are summarized into three levels as described in the hierarchy below:

- Level 1 — quoted prices in active markets for identical securities;
- Level 2 — other significant observable inputs (including quoted prices for similar securities, quoted prices in inactive markets for identical securities, interest rates, prepayment speeds, credit risk, etc.); and
- Level 3 — significant unobservable inputs (including the Manager's determination as to the fair value of investments).

The inputs or methodology used for valuing investments are not necessarily an indication of the level of risk associated with investing in those investments. The summary of the Fund's investments by inputs used to value the Fund's investments as of May 31, 2014, is as follows:

	Valuation Inputs		
	Level 1 – Quoted Prices	Level 2 – Other Significant Observable Inputs	Total Fair Value at 05/31/2014
ASSETS:			
INVESTMENTS (Fair Value):			
Domestic Equity Securities*	\$ 7,442,645	\$ —	\$ 7,442,645
Domestic Preferred Equity Securities*	45,162,946	—	45,162,946
Domestic Corporate Bonds*	—	59,408,080	59,408,080
U.S. Government Obligations	—	89,966,430	89,966,430
Money Market Funds	28,900,342	—	28,900,342
Miscellaneous Investments	8,469,014	—	8,469,014
TOTAL INVESTMENTS	<u>\$89,974,947</u>	<u>\$149,374,510</u>	<u>\$239,349,457</u>

* Industry classifications for these categories are detailed in the Schedule of Investments.

The Fund had no transfers between Level 1 and Level 2 during the six months ended May 31, 2014.

There were no Level 3 investments at May 31, 2014, or November 30, 2013.

Recent Accounting Standards: In June 2013, the Financial Accounting Standards Board (the "FASB") issued guidance that creates a two-tiered approach to assess whether an entity is an investment company. The guidance will also require an investment company to measure noncontrolling ownership interest in other investment companies at fair value and will require additional disclosures relating to investment company status, any changes thereto and information about financial support provided or contractually required to be provided to any of the investment company's investees. The guidance is effective for financial statements with fiscal years beginning on or after December 15, 2013, and interim periods within those fiscal years. Management is evaluating the impact of this guidance on the Fund's financial statement disclosures.

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NOTES TO FINANCIAL STATEMENTS (continued)
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Dividends and Distributions: The Fund records dividends and distributions to shareholders on the ex-dividend date. The Fund intends to declare and pay net investment income distributions, if any, quarterly in March, June, September, and December. The Fund intends to distribute any net long-term capital gains and any net short-term capital gains at least once a year. If the total dividends and distributions made in any tax year exceeds net investment income and accumulated realized capital gains, a portion of the total distribution may be treated as a tax return of capital.

Foreign Currency Translation: The books and records of the Fund are maintained in U.S. dollars. Foreign currency amounts are translated into U.S. dollars on the following basis: (i) fair value of investment securities, assets, and liabilities at the current rate of exchange; and (ii) purchases and sales of investment securities, income, and expenses at the relevant rates of exchange prevailing on the respective dates of such transactions. The Fund does not isolate that portion of gains and losses on investment securities which is due to changes in the foreign exchange rates from that which is due to changes in the market prices of such securities.

Estimates: The preparation of financial statements in conformity with U.S. GAAP requires the Fund to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of both contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Other: The Fund accounts for security transactions on the trade date for financial statement purposes. The specific identification method is used for determining gains or losses for financial statements and income tax purposes. Dividend income is recorded on the ex-dividend date net of foreign taxes withheld where recovery is uncertain and interest income is recorded on an accrual basis. Discounts and premiums on securities purchased are amortized over the life of the respective securities using the effective yield method. Securities denominated in currencies other than U.S. dollars are subject to changes in value due to fluctuation in exchange rates. The Fund may invest in countries that require governmental approval for the repatriation of investment income, capital, or the proceeds of sales of securities by foreign investors. In addition, if there is deterioration in a country's balance of payments or for other reasons, a country may impose temporary restrictions on foreign capital remittances abroad.

The Fund paid commissions and other brokerage fees during the period.

Note 3. Related Party Transactions

The Manager is a Delaware limited liability company and is registered with the Securities and Exchange Commission as an investment adviser. The Manager's principal business and occupation is to provide investment management and advisory services to individuals, corporations, and other institutions throughout the world. Pursuant to an Investment Management Agreement, the Fund pays a management fee to the Manager for its provision of investment advisory and operating services to the Fund. Subject to applicable waivers or limitations, the management fee is paid at an annual rate equal to 1.00% of the daily average net assets of the Fund. Under the Investment Management Agreement, the Manager is responsible for paying all of the Fund's expenses, including expenses for the following services: transfer agency, fund accounting, fund administration, custody, legal, audit, compliance, directors' fees, call center, fulfillment, travel, insurance, rent, printing, postage, and other office supplies, and excluding commissions, brokerage fees, and other transaction costs, taxes, interest, litigation expenses, and related expenses, and other extraordinary expenses.

Effective March 29, 2012, the Manager's contractual management fee waiver/expense reimbursement for the Fund expired. Prior to March 29, 2012, the Manager had contractually agreed to waive a portion of its management fee and/or limit the Fund's operating expenses (excluding taxes, interest, brokerage commissions, acquired fund fees and expenses, expenses incurred in connections with any merger or reorganization and extraordinary expenses such as litigation) so that the Fund's operating expenses, after such waiver or limitation payment, would not exceed an annual rate of 0.75% of the Fund's daily average net assets for the period March 30, 2011, to March 29, 2012. For the period December 31, 2009, to March 30, 2011, the Manager had contractually agreed to waive a portion of its management fee and/or limit the Fund's operating expenses

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NOTES TO FINANCIAL STATEMENTS (continued)
May 31, 2014 (unaudited)

(excluding those expenses noted above) so that the Fund's operating expenses, after such waiver or limitation payment, would not exceed an annual rate of 0.50% of the Fund's daily average net assets. The Manager may be reimbursed for fee waivers and/or expense limitation payments made in any fiscal year of the Fund over the following three fiscal years. Any reimbursement is subject to the Board's review and approval. A reimbursement may be requested by the Manager if the aggregate amount paid by the Fund for operating expenses for such fiscal year, taking into account any reimbursement, does not exceed the fee waiver/expense limitation in place at the time of the initial waiver or reimbursement of the amount by the Manager. For the six months ended May 31, 2014, the Manager may request reimbursement of up to the following:

For the period ended November 30, 2011, expiring November 30, 2014:	\$1,399,457
For the period ended November 30, 2012, expiring November 30, 2015:	<u>249,582</u>
	<u>\$1,649,039</u>

The Manager earned \$1,197,120 from the Fund for its services during the six months ended May 31, 2014.

Affiliates of the Manager held in aggregate 828,406 shares at May 31, 2014.

A Director and Officers of the Fund are also the Managing Member and Officers of the Manager or its affiliates.

Note 4. Investments

For the six months ended May 31, 2014, aggregated purchases and sales of investment securities other than short-term investments were as follows:

<u>Purchases</u>	<u>Sales</u>
\$28,576,246	\$10,320,469

Note 5. Tax Matters

Federal Income Taxes: The Fund intends to qualify each year as a "Regulated Investment Company" under Subchapter M of the Internal Revenue Code of 1986, as amended. By so qualifying, the Fund will not be subject to federal income taxes to the extent that it distributes all of its net investment income and any realized capital gains.

For U.S. federal income tax purposes, the cost of securities owned, gross unrealized appreciation, gross unrealized depreciation, and net unrealized appreciation of investments at May 31, 2014, were as follows:

<u>Cost</u>	<u>Gross Unrealized Appreciation</u>	<u>Gross Unrealized Depreciation</u>	<u>Net Unrealized Appreciation</u>
\$221,831,861	\$20,724,769	\$(3,207,173)	\$17,517,596

There were no differences between book basis and tax basis.

The Fund's tax basis capital gains are determined at the end of each fiscal year. Therefore, the components of distributable earnings will be included in the Annual Report for the fiscal year ended November 30, 2014.

The Manager has analyzed the Fund's tax positions taken on federal income tax returns for all open tax years (current and prior three tax years) and has concluded that there are no uncertain tax positions that require recognition of a tax liability. The Fund's federal and state income and federal excise tax returns for tax years for which the applicable statutes of limitations have not expired (the current year and the prior year) are subject to examination by the Internal Revenue Service and state

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NOTES TO FINANCIAL STATEMENTS (continued)
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departments of revenue. Additionally, the Fund is not aware of any tax position for which it is reasonably possible that the total amounts of unrecognized tax benefits will change materially in the next twelve months.

Note 6. Dividends and Distributions to Shareholders

Ordinary income and capital gain distributions are determined in accordance with federal income tax regulations, which may differ from U.S. GAAP.

The tax character of dividends and distributions paid by the Fund were as follows:

	<u>For the Six Months Ended May 31, 2014</u>	<u>For the Fiscal Year Ended November 30, 2013</u>
Dividends and Distributions paid from:		
Ordinary Income	\$ 1,644,215	\$14,560,171
Long-Term Capital Gain	<u>13,876,149</u>	<u>—</u>
	<u>\$15,520,364</u>	<u>\$14,560,171</u>

Note 7. Indemnifications

Under the Company's organizational documents, its Officers and Directors are indemnified against certain liabilities arising out of the performance of their duties to the Fund. In the normal course of business the Company or the Fund enter into contracts that contain a variety of representations and customary indemnifications. The Fund's maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Fund that have not yet occurred. However, based on its experience to date, the Fund expects the risk of loss to be remote.

THE FAIRHOLME FOCUSED INCOME FUND

ADDITIONAL INFORMATION
May 31, 2014 (unaudited)

Proxy Voting Policies, Procedures and Records (unaudited)

The Company has adopted policies and procedures that provide guidance and set forth parameters for the voting of proxies relating to securities held in the Fund's portfolio. A description of these policies and procedures, and records of how the Fund voted proxies relating to their portfolio securities during the most recent twelve month period ended June 30, 2012, are available to you upon request and free of charge by writing to Fairholme Funds, Inc., c/o BNY Mellon Investment Servicing (US) Inc., P.O. Box 9692, Providence, RI, 02940 or by calling Shareholder Services at 1-866-202-2263 or visiting our website at fairholmefunds.com. They may also be obtained by visiting the Securities and Exchange Commission ("SEC") website at www.sec.gov. The Company shall respond to all shareholder requests for records within three business days of its receipt of such request by first-class mail or other means designed to ensure prompt delivery.

N-Q Filing (unaudited)

The Company files a complete schedule of the Fund's portfolio holdings on Form N-Q for the fiscal quarters ending February 28 (February 29 during leap year) and August 31. The Form N-Q filing must be made within 60 days of the end of the quarter. The Forms N-Q relating to the Fund's portfolio investments are available on the SEC's website at www.sec.gov, or may be reviewed and copied at the SEC's Public Reference Room in Washington, DC (call 1-800-732-0330 for information on the operation of the Public Reference Room).

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Vice President

Wayne Kellner

Treasurer

Paul R. Thomson

Chief Compliance Officer & Secretary

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