Mutual fund investing involves risks, including loss of principal. The charts below cover the period from inception of The Fairholme Fund (December 29, 1999) to December 31, 2015. Unless otherwise specified, all holdings information is shown as of December 31, 2015. Past performance information quoted below does not guarantee future results. The investment return and principal value of an investment in The Fairholme 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 are after expenses and assume reinvestment of dividends and capital gains but do not reflect a 2.00% redemption fee on shares redeemed within 60 days of purchase. 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 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 Fund to the risk of unanticipated industry conditions and risks particular to a single company or the securities of a single company. The S&P 500 Index is a broad-based measurement of changes in the stock market, is used for comparative purposes only, and is not meant to be indicative of The Fairholme Fund's performance, asset composition, or volatility. The Fairholme Fund's performance may differ markedly from the performance of the S&P 500 Index in either up or down market trends. The performance of the S&P 500 Index is shown with all dividends reinvested and does not reflect any reduction in performance for the effects of transaction costs or management fees. Investors cannot invest directly in an index. The Fairholme Fund's total expense ratio reflected in its prospectus dated March 27, 2015, was 1.06%, which included acquired fund fees and expenses that were incurred indirectly by The Fairholme Fund as a result of investments in securities issued by one or more investment companies.

January 28, 2016

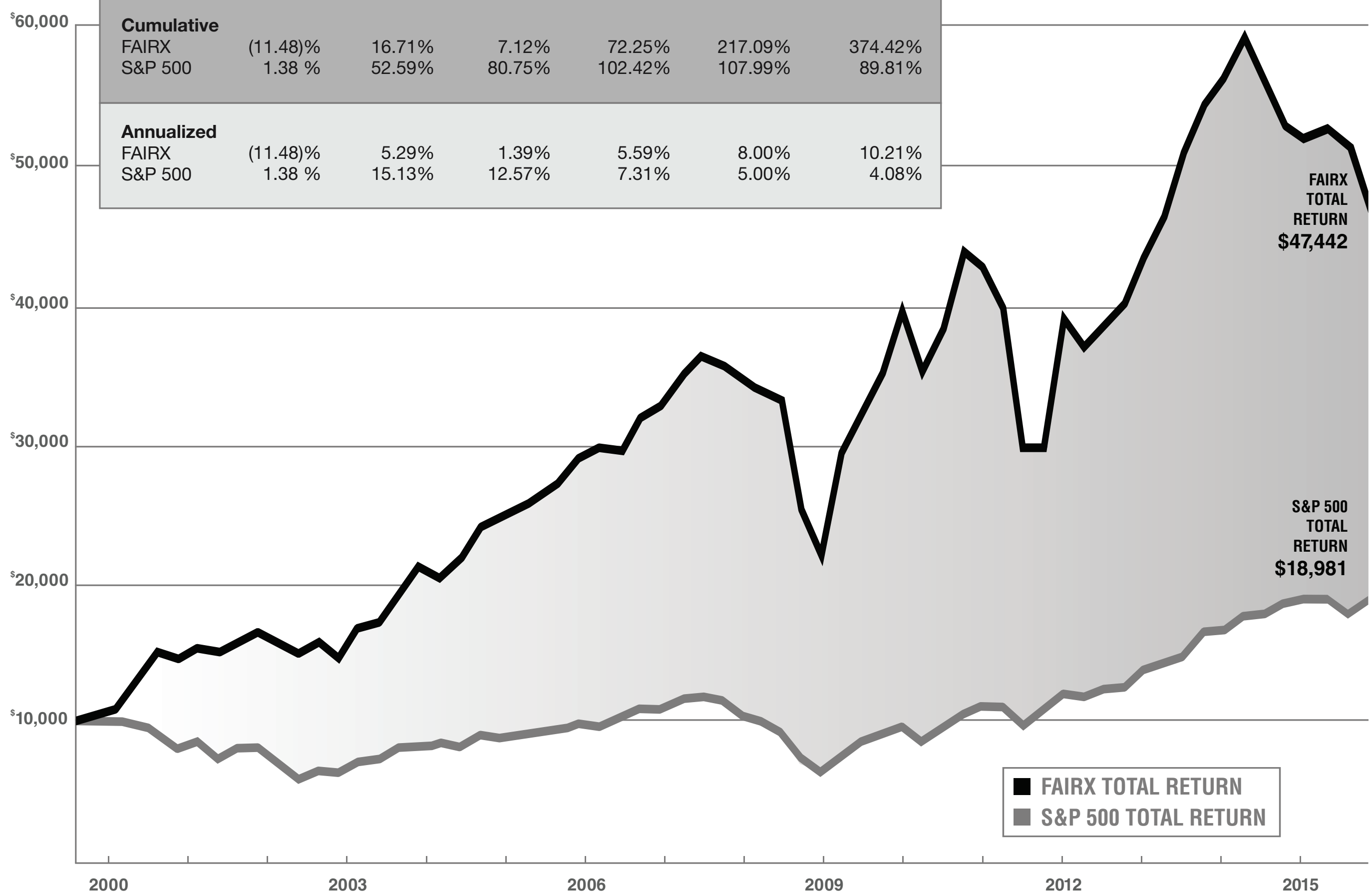
The Fairholme Fund vs. The S&P 500 Index

TOTAL ANNUAL RETURN		
Year	**The Fairholme Fund**	**The S&P 500 Index**
2000	46.5%	(9.1)%
2001	6.2%	(11.9)%
2002	(1.6)%	(22.1)%
2003	24.0%	28.7%
2004	24.9%	10.9%
2005	13.7%	4.9%
2006	16.7%	15.8%
2007	12.4%	5.5%
2008	(29.7)%	(37.0)%
2009	39.0%	26.5%
2010	25.5%	15.1%
2011	(32.4)%	2.1%
2012	35.8%	16.0%
2013	35.5%	32.4%
2014	(2.7)%	13.7%
2015	(11.5)%	1.4%
Compounded Annual Gain	**10.2%**	**4.1%**
Overall Gain	**374.4%**	**89.8%**

To the Shareholders and Directors of The Fairholme Fund:

The Fairholme Fund (the "Fund" or "FAIRX") decreased 11.48% versus a 1.38% gain for the S&P 500 Index (the "S&P 500") in 2015. The following table compares the Fund's unaudited performance (after expenses) with that of the S&P 500, with dividends and distributions reinvested, for various periods ending December 31, 2015.

	ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS	FIFTEEN YEARS	SINCE INCEPTION (12/29/1999)
Cumulative						
FAIRX	(11.48)%	16.71%	7.12%	72.25%	217.09%	374.42%
S&P 500	1.38 %	52.59%	80.75%	102.42%	107.99%	89.81%
Annualized						
FAIRX	(11.48)%	5.29%	1.39%	5.59%	8.00%	10.21%
S&P 500	1.38 %	15.13%	12.57%	7.31%	5.00%	4.08%



The value of a $10,000 investment in the Fund at its inception was worth $47,442 (assumes reinvestment of distributions into additional Fund shares) compared to $18,981 for the S&P 500 at year-end. Of the $47,442, the value of distributions reinvested was $28,942. It is clear a reinvestment strategy is rewarding.

Recent times have not been easy for all of us Fund shareholders. My three decades of experience dictates that the seeds of great performance are planted during the toughest of times. Above-average returns only seem painless in hindsight. After all, if it were easy, everyone would do it.

Fairholme remains focused on buying and holding securities characterized by large differences between our assessment of intrinsic value and their market price. Paying a cheap price relative to intrinsic value has determined much of Fairholme's performance success and helps protect against less-than-perfect future outcomes. Security prices and estimates of intrinsic value widen during bouts of market irrationality or times of crisis, but they usually converge. We try to take advantage of these bargains by buying securities of businesses with fixable problems trading at distressed prices. We only buy when the facts tell us to be greedy, especially when others are fearful. While holding our investments, we may appear wrong for extended periods, and in some instances, it can take years for a position to become an overnight success. We believe that point is near and maintain our strong conviction that the Fund's current securities are worth multiples of today's prices.

Historically, large and liquid markets have allowed the Fund to focus on a few, best ideas. Times have changed. Over the course of the year, the Fund reduced positions that appreciated and initiated investments in several new opportunities. Going forward, if markets remain less liquid, we will become less concentrated than in the past. Cash and equivalents now exceeding 20% of net assets provide ample dry powder.

American International Group

Fund shareholders have realized over $2 billion in gains from our investment in American International Group ("AIG") common stock. Today, our remaining AIG stake is composed of double-ratchet, long-dated warrants (14.2% of Fund assets) received in connection with AIG's 2011 recapitalization. These warrants are our largest position for three reasons: (i) AIG's common shares continue to trade at a meaningful discount to the company's tangible book value of nearly $80 per share; (ii) AIG has the potential to materially improve the cost structure of its property and casualty business, as its expense ratio remains higher than its peer group average; and (iii) future dividend increases and capital distributions will improve the conversion ratio and exercise price of the warrants until their 2021 expiry.

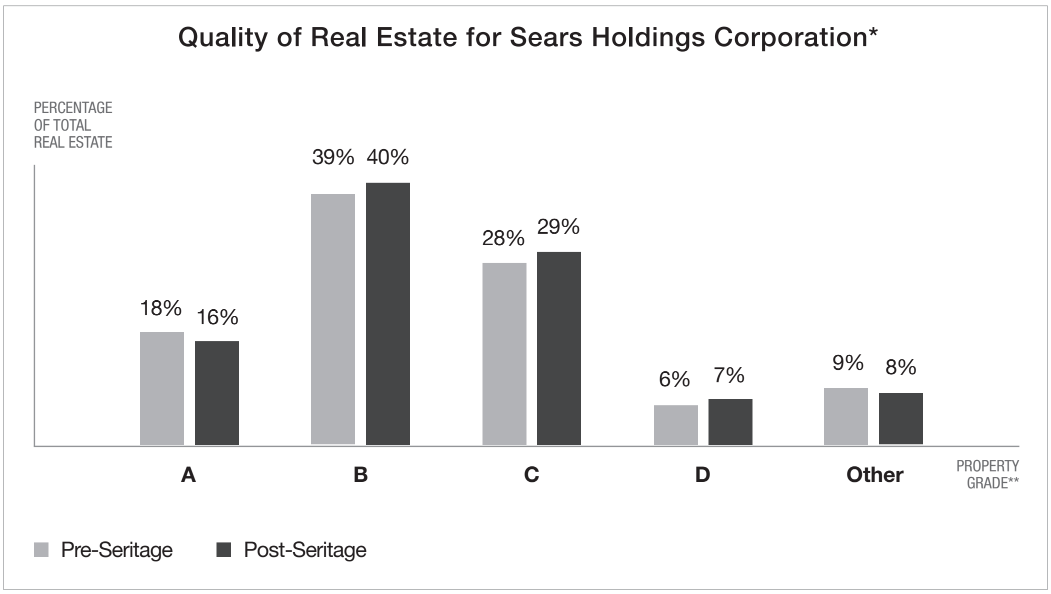
Sears Holdings Corporation

Sears Holdings Corporation ("Sears") common stock, warrants, and bonds comprise 13.2% of Fund assets. Our ongoing valuation work reinforces our longstanding belief that Sears is worth multiples of its current market price (as evidenced in the chart below), largely based on its vast real estate empire and disparate businesses configured to sell, deliver, connect, control, service, and replace all manner of consumer products. Throughout the year, the Fund took advantage of price declines to increase its stake.

Estimated Net Asset Value of Sears Holdings Corporation*	$Millions	Per Share
Real Estate	$15,772	$123
Kenmore, Craftsman, DieHard, Home Services	$5,150	$40
Net Inventory, Cash, and Accounts Receivable	$4,682	$37
Other Assets	$2,400	$19
Total Assets	$28,004	$219
Total Liabilities	($9,168)	($72)
Net Asset Value	**$18,836**	**$147**

**Estimate based on data as of Q3 2015.*

Last year's sale of 266 properties for $3.1 billion unlocked one-fourth of the company's real estate square footage. The properties included in the transaction were *not* exclusively the crème de la crème of the company's real estate portfolio as many have falsely asserted. Instead, the quality of the properties included in the transaction closely mirrors the approximately 170 million square feet of real estate retained by Sears today as depicted in the following chart.



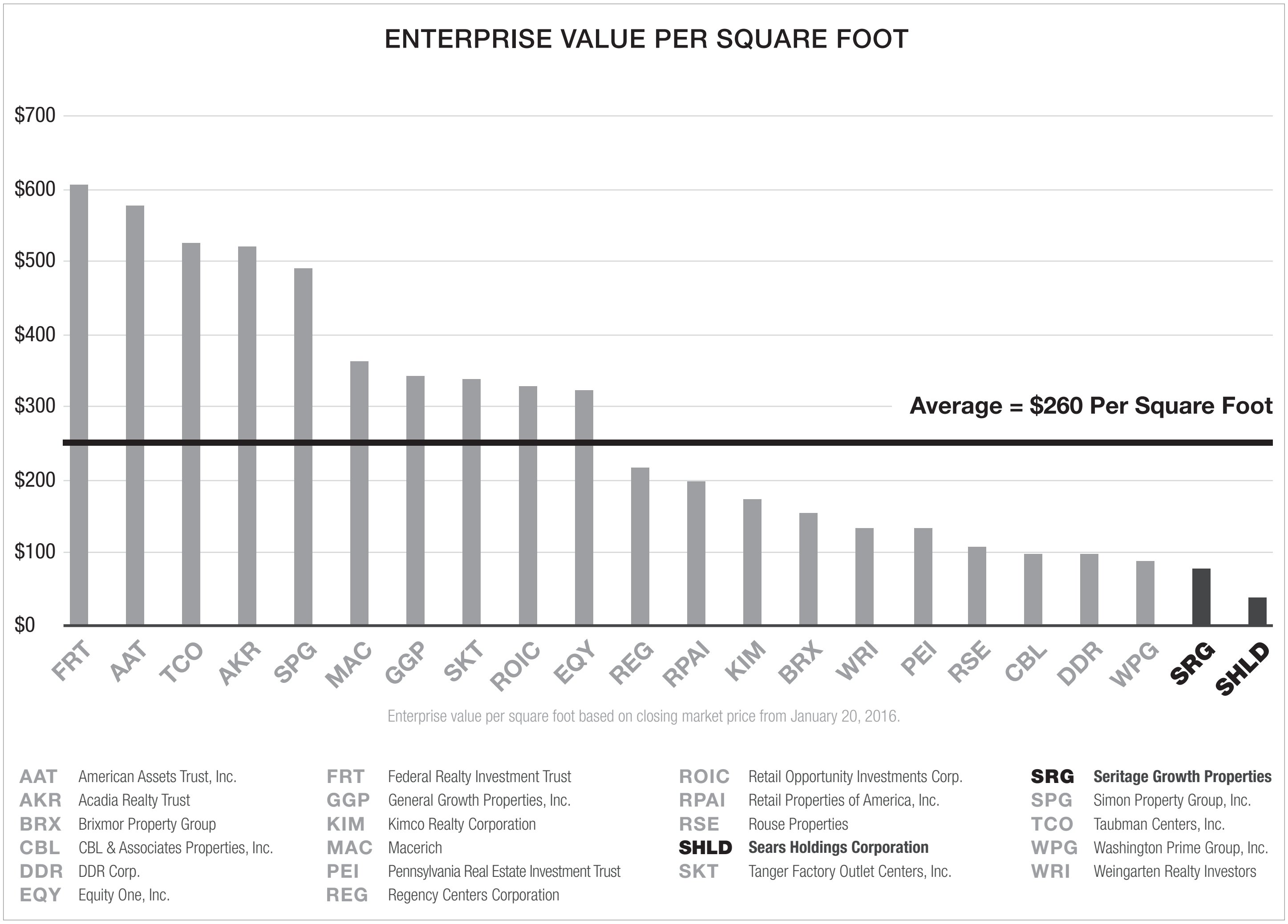
**Proprietary assessment based on publicly available information.*

Property Grades are derived from a proprietary research methodology developed by Fairholme Capital Management, LLC, corroborated by independent real estate professionals. The methodology utilizes key indicators of property and location value including revenue per square foot, local population and median household income demographics, presence of strategic tenants, and other measures.* ***Grade A *properties consistently ranked highest in most categories,* ***Grade B*** *properties predominantly scored higher than average in most categories,* ***Grade C*** *properties scored lower than average in most categories, and* ***Grade D*** *properties consistently ranked lowest in most categories.* ***Other*** *properties include freestanding Sears locations and unrated properties.*

Proceeds from the sale were used to reduce corporate debt by $936 million, and the company must now accelerate its return to profitability in order to rebuild confidence with customers, creditors, vendors, employees, and other investors. Doing so should enable Sears to optimize the value of all its assets.

Seritage Growth Properties

Seritage Growth Properties ("Seritage"), a newly formed public real estate investment trust (REIT) that purchased the aforementioned 266 properties from Sears in mid-2015, comprises 2.5% of Fund assets. Our detailed property-by-property analysis, which has been independently corroborated by third party real estate professionals, indicates that Seritage is significantly undervalued at current market prices. One can only speculate that Warren Buffett concurs with our assessment given his recent decision to personally acquire shares. Seritage's real estate portfolio, which includes 235 properties and joint venture interests in 31 additional properties, has the opportunity to command significantly higher rents. Seritage appears to have the largest development backlog of any national REIT, and will be able to develop more rentable space over time without a need for further acquisitions. Commentary from the company's joint venture partners – General Growth Properties, Macerich, and Simon Properties – about ongoing and future projects across the country only serves to reinforce our conclusions. As shown in the following chart, Seritage and Sears have two of the lowest priced real estate portfolios in the United States.



Fannie Mae and Freddie Mac

In 1986, famed Magellan Fund manager Peter Lynch touted Fannie Mae as "the best business, literally, in America." At that time, Fannie Mae had a price-to-earnings ratio of one. Lynch noted that "when a company can earn back the price of its stock in one year, you've found a good deal." Thirty years later, the price-to-earnings ratio of Fannie Mae is back at one – but the circumstances are quite different. In our view, current prices of Fannie Mae as well as its smaller cousin Freddie Mac do not reflect the economic value of existing assets, let alone future earnings power, embedded in these world-class franchises. Indeed, the companies are not priced for a run-off of their existing businesses; they are priced for the permanent expropriation of all assets.

Fannie Mae and Freddie Mac represent 16.4% of Fund assets, primarily in the form of preferred stock. For those unfamiliar, Fannie Mae and Freddie Mac are simple and straightforward insurance companies. They are *not* banks. There isn't a local Fannie Mae or Freddie Mac branch on the street corner. Unlike the big banks, Fannie Mae and Freddie Mac did not commit any consumer fraud in the run-up to the financial crisis. The two do not originate mortgages and they do not deal directly with individual homeowners. However, when it comes to funding our nation's housing market, Fannie Mae and Freddie Mac are mission critical. The companies have helped tens of millions of American families buy, rent, or refinance a home even during the toughest economic times when banks and other lenders shun mortgage risk. Bottom line: Fannie Mae and Freddie Mac *are* the housing finance system in America, and earn a nominal amount (less than 40 basis points) for ensuring that the venerable 30-year fixed-rate mortgage remains widely accessible and affordable.

During the 2008 financial crisis, Fannie Mae and Freddie Mac helped *save* America's home mortgage system and resuscitated our national economy by continuing to provide liquidity when credit and insurance markets froze solid. According to a comprehensive analysis by Thomas Ferguson and Robert Johnson published in the *International Journal of Political Economy,* federal regulators explicitly directed Fannie Mae and Freddie Mac to initiate massive purchases of "home mortgages and mortgage bonds to stem declines in those markets and alleviate pressures on the balance sheets of private firms," particularly "overburdened banks." Then in 2012, Treasury's decision to usurp all of the profits from each company in perpetuity (the so-called "Net Worth Sweep") improved the federal budget deficit in an election year *and* avoided protracted debt ceiling negotiations with Congressional Republicans.

Roger Parloff's recent *Fortune* magazine piece – "How Uncle Sam Nationalized Two Fortune 50 Companies" – details the de facto nationalization of Fannie Mae and Freddie Mac by the federal government and the determined effort by a handful of bureaucrats to hide the truth from the public:

> *For reasons that remain shrouded in secrecy to this day, the Treasury Department and the companies' conservator, the Federal Housing Finance Agency (FHFA) – two arms of the same government – agreed to radically change the terms of what the GSEs would owe in exchange for the moneys they had already received. Instead of a 10% annual dividend on all*

the bailout funds drawn … the dividend was now to be set at 100% of each GSE's net worth. One hundred percent. That is to say, any and all profit they posted. And this would be so in perpetuity ... The two firms, on their way back to health, were effectively nationalized. The sudden change was called the "third amendment," an innocuous-sounding designation that belies its momentous consequences … If this strikes you as, well, un-American, you're not alone … The government's alleged nationalization of two enormous corporations raises potentially landmark constitutional issues – comparable to President Harry Truman's attempt to nationalize steel mills during the Korean War … Seven years into their conservatorship, the GSEs remain adrift, with shrinking capital reserves and no exit plan—a dormant, festering crisis … Documents and depositions from officials at Treasury and FHFA, obtained in discovery in a suit brought by Fairholme Funds, show that the government's story is "highly misleading" in some respects and "outright false" in others, plaintiffs lawyers allege in court briefs … The lawyers can't tell the media (or even their clients) specifically what the documents and depositions show, however. That's because Court of Federal Claims Judge Margaret Sweeney has ordered those materials sealed from public view, at the government's behest. Bewilderingly, the Justice Department has persuaded her that disclosure of that information—concerning a now three- to eight-year-old decision-making process of tremendous public interest—might cause "dire harm" and "place this nation's financial markets in jeopardy" … The spectacle of a conservator wiping out shareholders just as the companies he's supervising are about to have their best years in history simply doesn't smell right. It's hard to picture the Supreme Court letting it stand.

The market gyrations experienced during 2015 do not reflect our progress in halting Treasury's unlawful taking of Fannie Mae's and Freddie Mac's assets. Indeed, newly discovered evidence – which shows the government's defense to be outright false – was subsequently presented to the D.C. Circuit Court (under seal as required), and plaintiffs in other cases from the Northern District of Iowa to the Eastern District of Kentucky have now obtained these documents as well. We remain confident that Treasury's deliberate effort to realign the equity of each company and allocate all profits to itself in perpetuity is strictly prohibited by federal and state law, and anticipate that several of these cases will be adjudicated this year.

Today, taxpayers own 79.9% of Fannie Mae and Freddie Mac. In this respect, taxpayers are fully aligned with private shareholders of these extremely valuable companies. In our view, anyone claiming that shareholders are seeking remuneration at "taxpayer expense" is peddling fiction. Only the disingenuous would assert that recapitalization of these companies would take decades and come at taxpayer expense, as if retaining earnings precluded the ability of each company to raise equity from private investors. Only those beholden to special interests would ignore the substantial reforms implemented at Fannie Mae and Freddie Mac over the last eight years and pretend that the companies are somehow doomed to repeat the past upon release from conservatorship. Only those who oppose the dream of American homeownership would attempt to dismantle President Franklin Roosevelt's *New Deal* by eliminating two publicly traded, shareholder-owned companies that have single-handedly provided $7 trillion dollars – yes, *trillion* – in liquidity to support America's mortgage market since 2009.

Shareholders simply request that the Treasury Department respect the capital structure of each company, respect the economic bundle of rights associated with our securities, and respect the law setting forth the rules of a conservatorship as decreed by Congress. The economist Herbert Stein once famously said: "If something cannot go on forever, it will stop." Sooner rather than later, we believe the Net Worth Sweep will be halted and a common sense solution will prevail: Fannie Mae and Freddie Mac will transform into low-risk, public utilities with regulated rates of return, just like your local electric company.

The St. Joe Company

The St. Joe Company ("St. Joe") comprises 12.8% of Fund assets. Today, St. Joe stands well capitalized and focused on future developments in Florida's Bay and Walton Counties. The company is entitled to develop 170,000 residential units and 22 million square feet of retail, commercial, and industrial facilities on 110,500 acres of nearly contiguous land on the "Emerald Coast." We believe that the intrinsic value of St. Joe's current entitlements and other assets is substantially higher than its recent market price, and were pleased that the company repurchased almost 17 million shares of its common stock (over 18% of the outstanding public float) at $18 per share in 2015.

Imperial Metals Corporation

Imperial Metals Corporation ("Imperial") common shares and senior unsecured notes due 2019 comprise 5.4% of Fund assets. We first bought Imperial after observing Murray Edwards develop Canadian Natural Resources Limited – particularly its massive Horizon oil sands project – into a world-class energy producer. We believe that Imperial's Red Chris mine is a replay of low-cost Horizon, but with one of the largest copper resources and the seventh largest gold deposit in the world. Imperial posted record production results in 2015, and we expect the company to weather the current commodity cycle while preparing for the next upswing.

Oil and Natural Gas Related Companies

A shale fracking revolution allows America to be an energy exporter. Supply increases have led to an oil and gas price collapse. Energy companies now sell for huge discounts from historic values, and related service businesses are trading at record lows as well. When the Fund last purchased large amounts of securities in the energy sector, no one thought that the world would function if oil exceeded $40 per barrel. We sold our positions when oil eclipsed $100 per barrel and few thought a return to $80 possible. Now, experts believe a price of $10 is possible and $50 per barrel a long way off. We again disagree. Prices cannot stay below marginal costs when demand grows and supply depletes – at least, not for too long.

In the immortal words of Yogi Berra, "It's déjà vu all over again." Common shares of MRC Global and NOW Inc. comprise 4.8% of Fund assets. Both companies operate in the supply chain and inventory management industry, and should be among the first to experience a rebound with higher oil and gas prices. Ultimately, MRC and NOW should consider a merger in order to create huge efficiencies and maximize value for all shareholders.

We are pleased to invite shareholders to join us for a public conference call in the near future, during which I will discuss the Fund's investments and address your questions. Details will be made available on www.fairholmefunds.com in the coming weeks, along with additional updated information on our investments.

Respectfully submitted,

Bruce R. Berkowitz
Chief Investment Officer
Fairholme Capital Management

For a copy of the top holdings for The Fairholme Fund, please *click here.* Portfolio holdings are subject to risk and may change at any time. Investors should consider the investment objectives, risks, charges, and expenses of the Fund carefully before investing. The Fund's prospectus contains this and other information about the Fund. To obtain a copy of the Fund's prospectus, please visit *www.fairholmefunds.com* or call *1-866-202-2263.* Please read the prospectus carefully before investing. The Portfolio Manager's Report is not part of The Fairholme Fund's 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.

Fairholme Distributors, LLC (01/16)