FAIRHOLME FUNDS, INC. SHAREHOLDER CONFERENCE CALL

May 9, 2011
11:00 a.m. ET

Operator: Good morning. My name is Jessica and I will be your conference operator today. At this time, I would like to welcome everyone to the Fairholme Funds, Inc. Shareholder Conference Call.

Before we begin please note this call will last one hour and is being recorded. Replay information is included in Fairholme's May 3, 2011 press release and is posted on www.fairholmefunds.com.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a Question and Answer session. In order to ask a question during this time, simply press "*" then "1" on your telephone keypad. To withdraw your question, please press the "#" key.

Thank you.

Brian Ehrlich: Good morning and welcome everyone. Thank you for joining us today. My name is Brian Ehrlich and I am the Director of Investor Relations at Fairholme. Participating in this call today will be Bruce Berkowitz and Charles M. Fernandez.

Bruce is the Founder, Managing Member and Chief Investment Officer of Fairholme, and President and a Director of Fairholme Funds, Inc. Charlie is the President, Chief Research Officer and Analyst for Fairholme, and Vice President and a Director of Fairholme Funds, Inc.

The format for today's call is as follows: Bruce will begin the call with an update on the Funds after which Bruce will answer commonly asked questions that were submitted via e-mail. Then we will open up the line for Q&A. The call will end no later than 12:00 pm.

I will now turn the call over to Bruce.

Bruce Berkowitz: Good morning. We have a lot of friends and shareholders on the line and we want to answer every question we can in the hour so I will be brief, with some opening comments. Here are my thoughts on the Fairholme Funds recent performance: horrible, [and] that's the summary in hindsight and it may be to be expected over the short term.

We've always stated in our reports that short-term performance should not be over emphasized. It’s the long term that counts. This is not the first time we've underperformed; it won't be the last time and I don't think it's reality to outperform every month, quarter or year.

So it's been lousy for months, we've been losing, we're way underperforming, and it may stay lousy for more time. In hindsight we swapped from health insurers and defense to financials too early.

We're in the financials with the belief that they are essential to the well-being of the economy. That they, in the aggregate, are huge chunks of the U.S.

financial system. We had similar arguments with respect to health care when many thought the health care industry was dead. We argued at the time that our companies were the health care system in the same way we argue today that our banks and brokers are the U.S. financial system.

Financials remain hated today and blamed for our country's economic troubles. They do deserve part of the blame but we all had a share in the process we're going through. But bottom line, in a perverse way, is that we need to fail short-term to outperform long-term.

We need to buy low and buy lower and buy lower. Even when the crowd yells you're wrong. This is how we've achieved our performance over the past decade and this is how we will achieve our performance in the next couple of decades.

Today's environment is very reminiscent of the 1990s, when the market bust, Wells Fargo was going bust and the banking system was crushed. We bought and we bought … and the process lasted for quite a bit of time and then we went on to make five to seven times our money. I think we'll do quite well in the future now. I don't know if we'll make five to seven times our money. I doubt it, but we are setting up for a good run.

Today the trends are quite positive. Balance sheets are strong and getting stronger. Banks have burned through over half of their difficult loans of 2007 and 2008 while writing great loans in 2009 and 2010. Today our banks, brokers are profitable and safe but still there's great uncertainty about legislation, lawsuits, regulations and future profitability.

Wall Street hates uncertainty; uncertainty creates a cheap price. Over 2011 this uncertainty will greatly diminish, the noise will reduce. Graham and Dodd quoted on the first page of Security Analysis, “Many shall be restored that now are fallen and many shall fall that now are in honor.”

Today, AIG is valued about two percent of its market price 10 years ago. The government wants to sell 1.6 billion shares, with their cost basis around $29 per share. Well I ask you, guess where the public offering will take place given the government is not in the business of making profits? My guess is $27, $29.

You could ask why do we hold? Well, I was wrong. I found it very hard to believe that the government would sell its stake below book value. And right now AIG is trading at two-thirds of book value. Last year AIG's remaining operations earned $12 billion before tax. That's over $6 a share, and the company will not pay taxes for a good few years. Benjamin Graham and David Dodd said many shall be restored.

People questioned us about JOE. It's been a tremendous amount of press… some correct, some incorrect but there has been too much press and stay-at-home shareholders are worried. Why spend so much time on a relatively small position? Why spread yourself too thin? Well, JOE does not have to remain small and JOE today is taking less and less time.

But we have to understand and the reason why we are in JOE, is that JOE is part of a master plan. In fact, Florida's largest. Billions have been spent on JOE's land, billions more will be spent by local, state and federal governments. And JOE, at its heart, is an asset manager.

New management at JOE will stop the expense bleed, fill the balance sheet and afford shareholders the patience for Florida's master plan to continue. It's that simple -- but it's not too simple.

So let me give you a quick summary. We moved too fast, headed too soon into the financials. We suffered from premature accumulation. Our companies continue to be priced for continuing stress and the price we paid reflects those stresses. And the prices we paid are quite cheap in our opinion compared to how these companies should perform in a more normal environment. Some people think we are spread too thin, we've slipped but I must tell you we are smack dab in the middle of our circle of competence in financial services.

Charlie, what have I missed in discussing our Fairholme Fund’s overall performance?

Charles M. Fernandez: I think you've been pretty clear on just about everything. The only thing I'd like to add is that basically today the banking industry leaders and associations are working hard with the regulators to try to create clarity. However, that said, we don't believe that's going to gain any kind of traction until after the numbers and reserves for the first half of the year are out. Because I think that's going to allow the regulators and the bankers to basically sit around the table and try to give clarity to the regulations. In our opinion, probably worst case would be after the third quarter numbers.

As it relates to JOE, and as you said, billions -- to be more exact $3.2 billion -- has been spent over the last five years in or around JOE land. There currently is an 18 to 24 month delay in funding which has created a backlog of approximately $1.7 billion.

However, due to the federal grant rules which allow projects to be stayed for up to three years, that backlog should begin to open by the first half of 2012. We estimate approximately two-thirds of those projects will begin in the first half of 2012.

So that's basically adding kind of a big stroke picture to what you said; I'm giving them some numbers.

Bruce Berkowitz: Great, thanks.

JOE's basically the history of real estate in the United States and the history of demographics, and the history of what happens when you plunk an international airport down in your backyard. Again, most of the heavy lifting is over, the time is patience on JOE and we shall move on.

Now I'm going to go through some of the top five questions that have come in to Fairholme via e-mail and by telephone over the past few weeks. So the first question is:

I am a very happy shareholder, I suppose others might be concerned with your recent year to date performance, of which I am not.

Perhaps you could speak to some of the portfolio metrics as a whole such as price of book, price of free cash flow, whatever metrics you feel are important since the financial sector is lagging and we are heavily skewed towards financials. Being a contrarian it would help me to understand the deep value of the portfolio as a whole as opposed to where our stocks are currently trading, which I ignore.

Well the portfolio matrix is: we're priced significantly less than 10 times normalized earnings, and we're priced significantly less than book value. We have a good margin of safety in our opinion on the price we've paid. And it's déjà vu all over again … it feels like 1992. The early '90s were the last banking crisis.

It’s as simple as that.

The next question is about the investment process:

Can you characterize how the investment process has evolved and/or changed over the last few years with the addition of Charlie and the departure of others? I'm not looking for a better or worse type answer but rather what that has meant to the investment process.

When people change, the process will always adjust even if it's only in a very subtle fashion. Does that shift more resources to outside experts, etc.?

Charlie joined Fairholme, and I wanted Charlie to be a big part of Fairholme because he's an operator. He's a business man with real world experience. He has experience dealing with lawyers, bankers, regulators, corporate execs on a business level.

Charlie was instrumental, for example, in our $500 million investment, AmeriCredit's, bonds and equity and the creation of $150 million private securitization. Instrumental in our $2 billion investment in GGP's busted bonds and $2.7 billion commitment in the restructuring of GGP.

Those two examples alone generated $2 billion of profit for Fairholme shareholders and in my opinion this is exponentially more than what all previous employees combined [contributed] to the firm.

What we've done there could not have occurred with our old configuration and what brought us to where we are today will not get us to where we need to be when we started and reached a billion. We had to change up to get to 10 billion, we had to change up again from 10 billion to 20 billion, and again from 20 billion plus. We need to be different, we need to evolve. I believe Andrew Grove calls that “creative destruction” and I believe it's in his book *Only the Paranoid Survive*.

Next question, which sums up many questions:

Can you give us a summary of your three funds that is more telling than the prospectus is: objectives, differences, similarities, what type of investors is it appropriate for?

Our two newer Funds are what I consider to be adjacent funds for Fairholme Funds shareholders. In 2008, shareholders asked for an income-oriented fund, so we created the Fairholme Focused Income Fund. [In] 2009, shareholders asked for a fund that could take advantage of small quantity ideas, given the growth of the Fairholme Fund. For that reason, we created the Fairholme Allocation Fund.

Now the Fairholme Focused Income Fund is doing quite well. The new Fairholme Allocation Fund is lagging, so I'll give you an example of what the differences are between the Fairholme Fund, the Fairholme Allocation Fund and the Fairholme Focused Income Fund.

And the example will be with MBIA, the municipal bond and asset insurer. Because of the Fairholme Fund size we were limited to buying up to 10% of the company per regulations which created a relatively small position in the Fairholme Fund. MBIA, even though it's not that small of a company, we put it in the category of a small quantity idea.

But from our latest release of our investment, you'll see that in the Fairholme Allocation Fund MBIA is a 13% position. If you take a look at the Fairholme Income Fund you'll see MBIA bond positions, which we believe are money good and have a tremendous yield.

One more question that summarizes many questions:

Has the Fairholme Fund become too big to maneuver? Is there a capacity threshold that once crossed will begin to impact potential returns?

I don't think the Fairholme Fund is too big. And yes there will be a capacity threshold, but right now that capacity threshold is going to be more dependent on the environment and opportunities that present themselves.

Today we can use more capital. There is more to do in size but when the sun is shining bright and optimism runs high we will stop the inflows. If necessary, we'll send cash back. We have a smart group of shareholders. You will know when we get too big.

Given my investments in the fund, the better course of action for shareholders will be the right course of action for me. That is, if we're not capable of generating good returns for the size because of size, then we will shrink.

So at this point that summarizes most of the questions, and I am now going to ask Jessica to remind everyone how to queue up.

Operator: At this time I would like to remind everyone in order to ask a question, press "*" then the number "1" on your telephone keypad. We'll pause for moment to compile the Q&A roster. And again, that's "* 1" on your telephone keypad.

Your first shareholder call question.

Caller: Good morning Bruce. Buffett said at the meeting last week out in Omaha that he still has faith in Wells Fargo but he thinks with the new banking regulations with respect to leverage and so forth that they were not going to make the kind of money that they made in the past. I would just like your views a little more on what the new banking regulations with respect to capitalization as well as debit card, credit card regulations. What do you think that's going to mean to the financial companies going forward?

Bruce Berkowitz: Hello. Thanks for the question.

I agree. I do not believe the banks, brokers will make what they were making at the peak times. But, the investment return that shareholders make will be based in good part on the price we paid for the investment. After all, the investment process is a question of what you give versus what you get over time.

And I believe the price that we paid for our investments more than not reflected a compression in profitability. In fact, it still reflects the possibility that some of our companies will not make anything at all. And still reflects great uncertainty.

As to the new regulations, we know the worst case, what's been published, but as far as I know nothing has been decided yet. This is very reminiscent of the new regulations at large for health care. Where once those regulations were proposed we thought the industry was dead and where are we now? There have been changes for the good but you have a prospering highly profitable health care insurance industry.

So we have to wait and see how the rules and regulations are eventually shaped, molded, changed with the interaction of various committees, regulators and industry participants.

Caller: Thank you.

Bruce Berkowitz: All right, thanks.

Next question please.

Operator: Your next shareholder question.

Caller: Good morning Bruce, thanks for doing today's call. I just wanted to ask if you could walk us through your thesis on AIG given where things stand now and that the government will be selling below book value. What do you think the intrinsic value is and how long do you think it'll take to actually materialize?

Bruce Berkowitz: The intrinsic value is significantly higher, in my opinion, than where we bought AIG and where AIG is trading today. Chartis, Sun America are intact, they made reasonably good money last year, fabulous money compared to the price where the stock is today. I see no reason why AIG can't make a 10% return on equity.

I see no reason why they can't meet their goals for the next few years. There's tremendous value in AIG …people spent a huge amount of time focused on the right hand side of the balance sheet. It's now time for people to take a look at the left hand side and have a better understanding of the earnings power of the remaining companies and a better understanding of the assets and liabilities.

For example, the $23 billion deferred tax asset valuation allowance is not on the books. As the company begins to earn a more consistent profitability stream you will see that tax deferred asset come onto the books.

As I mentioned in my opening comments, I can see the company earning about $6 per share, pre-tax and, on a normal basis, they will not pay taxes on that for quite a few years. As that process evolves you'll start to see that grow and earn more pre-tax.

So that's the basic thesis. They've been under a microscope for three long years. There's a huge overhang of stock and there I was wrong. I thought that our government would sell the stock at a higher price, but they're willing to sell it at a lower price. Once that overhang's finished there'll be greater amounts of uncertainty put aside, removed. There'll be other uncertainties, but there's more time to think about, to spend time focused on the asset side of the balance sheet.

Caller: Just one quick follow-in question if I may.

Bruce Berkowitz: Sure.

Caller: What will the timing be for selling the government stake, over what period of time will they be reducing their position?

Bruce Berkowitz: This year.

Caller: OK.

Bruce Berkowitz: I think a big chunk will be sold relatively soon before hurricane season and then I would expect that there would be good demand for anything that may remain after hurricane season. And I would hope that it's all finished by year end.

Caller: Thank you.

Bruce Berkowitz: Thank you.

Operator: Your next shareholder question.

Caller: Hello, could you please discuss any hard catalysts that you see for Sears?

Bruce Berkowitz: I've described Sears in the past as a long term win-win. No one believed that Eddie Lampert and team can pull it off on the retailing side. Kind of reminds me of Apple when everyone thought Apple was about to fail and Microsoft had to inject capital into Apple to keep them around as a competitor.

If they do succeed as a retailer then that would be very positive for the stock. If they do not and the stock price stays low or goes lower I believe the company will continue to buy back shares. And eventually Fairholme, ESL, a few other shareholders will own the entire company. The assets that remain will work out quite well.

Whether Sears is a melting ice cube or becomes, heaven forbid, a growth story I think we'll be just fine.

You've got to give the guy a break and the company a break. We're coming out of the Great Recession, maybe the greatest recession since the Depression. Sears is very much tied to the housing market. So we've hung in there and we're going to continue to hang in there. I just don't see how we get hurt with Sears.

Maybe we make an awful lot of money, time will tell. So far I've been wrong.

Caller: Sounds like nothing new in your thesis.

Bruce Berkowitz: No, there's nothing new in my thesis at all at this time.

Caller: OK thank you.

Bruce Berkowitz: Thank you.

Operator: Your next question.

Caller: Hey Bruce, thanks for taking time to do the call.

Bruce Berkowitz: Thank you.

Ryan DeCaro: I wanted to see if you could comment on the Einhorn and Tilson presentation on JOE. They both mentioned that WindMark is "a ghost town." I just wanted to see what you had to say about that and the valuation of JOE's land.

Bruce Berkowitz: Whitney did send me the presentation, and where he quotes David's presentation. Is WindMark quiet? The answer is yes. But when I looked at the presentation Whitney mentioned 70 units with a developing loss. He mentioned part of the commercial space, where we have 31 condominiums which I think he valued at $5 million. We valued it much more.

But, this is part of WindMark by the way, there's no mention of the commercial space. There's no mention of 83 undeveloped lots on non-beach. There's no mention of 1,200 units, lots west of the village center, which by the way is two miles of beach. There's no mention of Fisherman's Pier, which is part of WindMark.

There's no mention of the hotel commercial land. We disagree on what was mentioned as part of WindMark, but most of WindMark is not mentioned. A relatively small 20%, 25% -- I can't tell. I'm looking at a map right now and there's just huge chunks of the project which is not mentioned.

So I have trouble really commenting on it. For example, you know a good 1,800 acres were left out. Maybe only 62 acres have been developed. So I don't know what to say, it's hard. We're comparing apples and oranges. Does that help?

Caller: Sort of.

Bruce Berkowitz: Well what part did I miss on that?

Caller: I guess it's just hard to understand whatever they don't mention.

Bruce Berkowitz: Well it's hard to understand that most of WindMark is left out of the evaluation?

Caller: I guess that's what makes the valuation hard to understand, yes.

Bruce Berkowitz: Exactly. But you know the best thing is, you should judge for yourself. JOE [will] have an annual meeting on May 17, you should use your own eyes, take a look around. Judge for yourself.

I hope that helped to answer the question and the differences in value.

You know reasonable people are welcome to disagree and should disagree. Charlie and I disagree. Sometimes we have a wide range on valuation. But you can't leave out huge chunks of reality.

Caller: Right.

Bruce Berkowitz: Thanks for the question.

Caller: All right thank you.

Operator: Your next shareholder question.

Caller: Good morning Bruce and thanks for having this call.

Bruce Berkowitz: Thanks.

Caller: Just as an aside I personally am a shareholder but even more importantly have put the preponderance of my parents and brothers and sisters in the Fairholme Fund as well. So my skin is very much in the game.

The question I have is kind of a derivative from some of the things that Charlie Munger brings up frequently… I'm paraphrasing now but I know he said numerous times that he is continually shocked by how big of an influence incentives have on people and how little it's appreciated.

I'm just wondering if the size of the Fairholme Fund now, the additional Funds, the fact that the one percent fees that are charged has become a big enough factor in how you live your life that maybe the hunger is not there and the returns we've seen over the last 10 years are not to be anticipated over the next ten or 20 years?

Bruce Berkowitz: I think it's a great question. And incentives do play a huge part in how people make decisions and how they live their lives and that's the reason why I've put every penny of my family's net worth in the Fairholme Fund. So that at a conscious and subconscious level I do not let management fees … What's the point of making money on the left hand when you lose it with the right hand? In terms of hunger, at the end of the day people do what they want to do. They may not realize it but they do what they want to do. This is what I enjoy doing and I'll continue to do it as long as I enjoy doing it. The hunger's still there, you can see the hunger, I believe based upon the portfolio. A somewhat rather passive person would not have the portfolio configuration that we have today.

I promise you after working hard for 25 years, I don't want to screw up the reputation or returns. It's just not worth the money. So we're very much hungry, working as hard as ever trying to put ourselves in your shoes, in the shoes of our shareholders every day and making every decision based upon that.

Caller: OK thank you. Can I ask a derivative question off of that?

Bruce Berkowitz: Sure, go ahead.

Caller: So when you weigh the possibilities of either closing the Fairholme Fund or diversifying into different funds where you have opportunities to fish in… waters that have become too shallow for the Fairholme Fund, how do you think about the risks of spreading yourself too thin or maybe moving out of what has traditionally been your breadbasket.

What are the factors that you go over between either closing the Fairholme Fund, returning some money, continuing to do what has worked so successfully in the past versus diversifying somewhat and running the risk of possibly spreading yourself too thinly?

Bruce Berkowitz: What is fascinating is that right now I am smack dab in the middle of what people consider to be my circle of competence: the financial services. This is where I made my name, this is where I made my biggest return, this is where I have the most experience. So I am laser-focused on financial services.

But people may not fully comprehend that and for example no one has asked or noticed so far the investments that we've made in Asia and maybe that's in the category of spreading ourselves too thin. One wonderful feature, benefit of owning AIG was being able to put three-quarters of a billion dollars to work in AIA.

A very large life insurer focused on Asia run by a great guy, Mark Tucker. That is actually the division at the beginning of AIG, in Shanghai in 1920, '30 and AIG led to AIA. It’s what we understand and it allowed us what I considered to be what one author calls the adjacent parcel.

It's allowed us to take a step further, expand our circle by going to a different geographic location but basically with a company that we understood because of its 100% ownership by AIG.

And that move then allowed us to take a next small step in our investment in the China Pacific Insurance (Group), which is a multi-line insurer focused 100% in China, who the majority owners are Chinese state enterprises. We were very lucky because of AIA and very grateful to be able to participate in that investment and recently we had the management team, Chairman Gao and roughly 15 of its management come from Shanghai to visit us in Miami and it is a most incredible operation.

If you close your eyes you're listening to Berkshire Hathaway, owners come first. You must think like owners. You must have a Fort Knox balance sheet. Underwriting must come first. You cannot lose on your investment. You must have a maximum on all insurance risks that you take. Very impressive. AIA very impressive, China Pacific Insurance very impressive.

That gets into the category of spreading yourselves too thin. I don't believe so. I believe we're evolving and we're of a size now where we can't keep buying and selling. We've had a lot of frenetic activity because of the past recession to protect shareholders but now it's time for Charlie and me to find investments that we can hold onto for many, many years.

As I have with Berkshire Hathaway or Leucadia and I hope that helps.

Caller: It does and thank you.

Bruce Berkowitz: Thank you.

Operator: Your next question.

Caller: Good morning Bruce and thank you very much for doing this conference call. You may have answered this question somewhat in previous remarks but what was on my mind was do you have a strategy for improving the performance of the Fairholme Fund other than just, say, the financials and AIG will turn around in time?

Bruce Berkowitz: That is the strategy. That is exactly how it happened in the '90s. You know there's a reason why you outperform over the long term. It's because you take unpopular positions, you go to stressed areas. My crystal ball isn't very good. Some people call it the equivalent of catching knives. What we are doing right now is exactly how I have achieved long term performance over my career. I just don't have the ability to time it.

I am usually too soon. Can't help it, they have not come up with medication for premature accumulation so far. I believe that we will be well rewarded for our patience. This is how you do it. You have to buy low and you have to have the patience and the courage and the understanding to buy lower and to buy lower.

Now of course this is not a sufficient condition to making lots of money but if you are right in what you know and you do go through that process then the returns can be quite healthy.

Patience should pay, as it has many, many times in the past. I believe the strategy is sound and the way you can tell if my strategy is sound is by going to the website of the financial institutions which we own, and listening to their most recent conference calls. AIG was last week, Bank of America announced, you can listen to the calls and take a look at the profitability, the trends are positive. The environment's getting better, balance sheets are getting stronger and stronger. The earnings are there and building.

The facts tell me that the companies we've invested in are underpriced but I have no control over the gap between perception and reality.

I hope that helps, I wish I could tell you something different or I had a magic formula to just turn it around today or tomorrow. I just don't.

Caller: OK it does help, thank you very much.

Bruce Berkowitz: Thank you.

Operator: Your next shareholder question.

Caller: Well great, thank you and thanks for the call today.

First question regarding the banks of the sector: Are you concerned at all that you know when a sector does get decimated as the financials did that they do tend to rebound and then after that they're kind of underperformers for quite some time? There aren’t too many times that an asset class will take over leadership after being decimated.

Also any comments on the Citi reverse stock splits and then lastly current cash that you have. Are you looking to average down or are you looking at new ideas? Thanks again.

Bruce Berkowitz: Thank you.

My experience in the banking sector and in many sectors under stress is that pricing goes to your logical extreme, especially with highly leveraged companies that at one point maybe not have made it.

So the last time this happened in the '90s we had five, seven, ten years of very good performance. We've seen this play before. Are the facts exactly the same? No. But we made a mistake, we got out, after making very good money in the health insurance industry we got out too soon. We left a lot of profit on the table.

Your question is a very high class problem which we'll have to assess when the banks go into a more normal environment.

In terms of the Citi reverse stock split, mostly agnostic but it helps if it reduces the price of transacting, reduces the speculation, reduces Citi's expenses. Other than that I really don't have much more to say.

Banks averaging down? That's what we do. That's how we've gotten to where we are and the facts continue to tell me that the banking sector is improving but stock prices continue to be pushed down. If we can, we'll buy more. That's part of the reason for all that cash we hold. Plus, we do have a pipeline of potential new investments but I believe that our banks, our financial services companies will be our big performers.

Does that answer your question?

Caller: It does. Thanks a lot. And then just lastly, if you were a new investor where do you see the most opportunities between the Fairholme Fund and the Fairholme Allocation Fund.

Thank you again.

Bruce Berkowitz: I'm going to leave that. That depends upon a specific investor's objectives, financial net worth. I'm going to leave that one up to the investor. We'll just try and explain the differences among the three and tell you we don't know which ones are going to outperform. But thanks.

Caller: Great thank you.

Operator: Your next shareholder question.

Caller: Yes thanks Bruce for the call.

You haven't mentioned one aspect of financials that have deterred others from investing in them and that is the derivative books that banks and others have. I wonder how confident you are of the transparency of the balance sheets of these institutions with the size of their derivative books.

Bruce Berkowitz: Great, well derivatives, like loans and insurance reserves, involve estimates and the key, the reason why we did not get into the banks too soon is that I believe that we let enough time lapse from the difficult 2007 and 2008 period to see the vestiges and to understand how they would develop.

I believe that enough time has gone by to see the patterns, to see the hits that have been taken, to have a pretty good idea as to where this is all heading. The recent quarters pretty much show that to be true. But do we know every loan? No. Do we know every derivative? No. Do we know every reserve for every insurance policy? No.

We have used time to cure uncertainty and we've used a very pessimistic three years and past history to understand that there is no incentive for any executive, any regulator, any authority to be optimistic as to the final results. Honeymoon period's over, there's no chance for any management team out there to be optimistic in their assessments of what they have.

So that is a very important item. For example, this is what we learned from our experience with AmeriCredit. After about 18 months, you got a very good understanding of the end result of subprime auto loans. You know residential, consumer loans can range three to six years depending whether commercial, whether variable, whether fixed. Maybe for 2007 there's 30%, 38% left, 37% left for 2008 on average it should be under 50% left. You assume the trends: you have a sense of how it's going to end in derivatives.

Derivatives are derived from what? From the loan. So that's where we stand on it. I hope that was helpful.

Caller: OK so are you comfortable with transparency?

Bruce Berkowitz: I am comfortable. It's as transparent as it's ever going to be. We have huge amounts of information -- whether it's from the companies themselves or from the U.S. Treasury, from TARP programs whether it's a GAO, fiscal responsibility, the Congressional Oversight Panel, auditors. There are a lot of points for you to look at, and yes we're comfortable.

We've burned through a lot of this, enough time has gone by.

Caller: OK thank you very much.

Bruce Berkowitz: Thank you.

Operator: Your next shareholder question.

Caller: Hey Bruce I appreciate the call, a long time shareholder. Probably the largest holding for all my clients' wealth.

Bruce Berkowitz: Thank you.

Caller: How do you position the Focused Income Fund? You'd like to think that over the next three years [investors] could definitely count on a three to five percent rate of return.

And, when do you think you'll get back into energy…if you ever will?

Bruce Berkowitz: The Fairholme Focused Income Fund is income-oriented and that is the major goal but let me be very clear you can lose money with the Fairholme Focused Income Fund.

Caller: Yes.

Bruce Berkowitz: But because of the instruments and the high level of income that they're generating that we have found and to some extent the Fairholme Focused Income Fund and the Fairholme Allocation Fund really greatly benefit from the size of the Fairholme Fund in terms of bits and pieces we may find in our normal research with the Fairholme Fund where they may not be appropriate for the Fairholme Fund but would be appropriate for the Fairholme Focused Income Fund.

Caller: Is it a two year time horizon at least, three year time horizon?

Bruce Berkowitz: I think that a three year time horizon is great for all the funds.

Caller: Yes.

Bruce Berkowitz: I think anything less than one year I wouldn't think about putting a penny into any of the Funds.

Caller: I agree with that.

Bruce Berkowitz: On the energy [sector], I just don't know. You know, a high price usually lowers demand creates supply. We did very well a few years ago. We missed this latest run up. I really don't know. The answer is I don't expect us to get back in anytime soon. But that may be famous last words.

Caller: Perfect there in '08. So I thought it was just pretty incredible that's why I was curious.

Bruce Berkowitz: Well you know what they say, better lucky than skillful.

Caller: That's right. Thanks a lot Bruce, appreciate it.

Bruce Berkowitz: Thank you.

Operator: Your next shareholder question.

Caller: Good morning and thanks for this call Bruce.

Building on your comments about AIA and China Pacific, can you speak a little bit if you're creating a strategy for international and if you're looking into other countries in Asia, other regions like Latin America to diversify your international holdings?

Bruce Berkowitz: Yes. In terms of expanding beyond Asia. I don't know if an opportunity comes about, there's no set strategy. From our visits to Asia it is … the analogy of the United States in the 1950s, where a giant middle class was developing.

I remember growing up with that middle class dream and the dream of my parents that I would have a better life than they have. Life insurance was very important. That life insurance policy was very important in terms of cash value, debt value. You know you can go to work and have a smile on your face that no matter what, your children are going to be OK, your spouse is going to be OK.

This was again during a period where the middle class was greatly expanding in the United States and you have that situation today in China, other parts of Asia but only on an exponential basis. So the product we understand, product I've lived with my whole life. The rules are different in Asia as to promises that can be made in terms of max, mins, amounts, regulation is quite tough.

We are very excited about AIA and China Pacific and we hope that we can find more of such high quality companies and management. It's very hard to explain, you have to be there, you have to see it, you have to talk with the management. You have to listen to the regulators and it can almost turn your world upside down as to what you would expect things to be there and it's fascinating.

We’re very slowly, carefully expanding our circle. Where it leads, I have no idea today. A dollar doesn't know how it's made. So if we can feel confident, have experience, believe we can, we can't hurt our shareholders, we're not going to lose money and we could potentially make some good money, we'll go there.

Caller: Sure. And if I could just squeeze in a quick question on AIG. As far as AIG warrants, are you able to hold those in the Fund or did you have to divest them and reinvest in AIG?

Bruce Berkowitz: We have all of the warrants. For every share of AIG stock in the Fund, we received half a warrant.

Caller: OK. And do you have any opinion on the value of the warrants versus the common share equity?

Bruce Berkowitz: No. We held onto both, we like both. One obviously is more speculative than the other.

Caller: Sure, great. Thanks a lot.

Bruce Berkowitz: All right, thanks.

I guess this is going to be our last question please.

Operator: Your final shareholder question.

Caller: Thanks Bruce, this has been very informative today. You've been investing with the wind at your back, monies flowing into the Fund since inception. I'm guessing that you may be experiencing the opposite effect now and how does that change your day-to-day managing of these assets?

Bruce Berkowitz: It doesn't in that it was always an expectation that one day money would flow out from poor relative performance. It's just nonsensical for us to think that we're just going to outperform all of the time.

Going through 2008, we also understand that money can leave the Fund for reasons that have nothing to do with the Fund. So in a way it's interesting. We have more than enough cash. We still have significant amounts of cash. We plan for this. Any redemptions we may have just give us more of what we like and want to own more of.

I hope that helps.

Caller: If I could just follow-up real quickly, I know you obviously have a tremendous investment in the financial system and the banks, and it seems to me that it's going to be very difficult for there to be a turnaround there until we see some real estate stability. It was reported that for almost five years in a row real estate prices have declined. When does that stabilize in your mind?

Bruce Berkowitz: When people have confidence, when uncertainty is cleared up. We've been through this before. We'll go through it again. The early '70s were a devastating time. It's a question of time and whether or not our financial institutions have the wherewithal to wait for their confidence.

They do, their balance sheets have never looked better, they're making money, they're working through the real estate issue. Continuing to work through it, there's probably another 18 months of working through residential real estate. That will be the last uncertainty to go. But we'll get there and we'll move on.

It's really time for all the plays in the financial system to settle up and move on. A lot of uncertainties, lawsuits, A suing B, B suing A, uncertainty about regulations. We need the uncertainty to finish, to be greatly diminished. We need the government to do its part. We need our companies to sort of settle up with each other on any disputes. We need to keep working through the troubled real estate as we're doing and we will build confidence and we're off to the races.

When? I don't know. But it will happen.

Brian Ehrlich: Bruce it looks like we're all out of time. We'd like to thank everyone for joining our call today. Just a reminder, a replay of the call and a transcript will be available on our website, www.fairholmefunds.com. Please feel free to call our shareholder services line if you have any other questions or e-mail us at investorrelations@fairholme.net. The shareholder services number is 1-866-202-2263.

Charles M. Fernandez: Thank you.

Bruce Berkowitz: And thank everyone.

Thank you for joining us on this call and giving us the trust and confidence. We'll try our best not to let you down.

Operator: This concludes today's Conference Call.

END