

THE FAIRHOLME FUND

ANNUAL REPORT 2002

January 8, 2003

Dear Fellow Shareholder,

Below is a comparison of the Fund's performance and that of the Standard & Poor's 500 Index (both with dividends reinvested) for the Fund's fiscal year ended November 30, 2002 and since inception.

	Fiscal Year Ended Nov. 30, 2002	Cumulative Since Inception
The Fairholme Fund	+1.8%	+55.5%
S&P 500 Index	-16.5%	-33.2%

While the Fund gained for the fiscal year, its net asset value declined by about 1.5% for the calendar year compared to a decline of 22.2% for the S&P 500 Index (with dividends reinvested).

Our uninspiring absolute performance was due in large part to our investment in Household International, which is being taken over by HSBC, a global bank. Not long ago your adviser purchased Household shares at an average price of \$42. While our purchase price was less than ten times expected earnings, we did not foresee how a confluence of negative events could make Household prey to a bargain basement takeover of about \$30 per share in stock of the acquirer. With the merger moving forward, thoughts on Household have turned to HSBC, richly priced yet making a great acquisition.

Also affecting performance were our property and casualty (P&C) insurance businesses. Despite volume increases, high premium rates, and better terms and conditions, their stock prices declined. Although intrinsic value increased, you never know how the market will vote in any given year.

On a positive note, Morningstar has recognized our relative performance of nearly 90 percentage points greater than the S&P 500 over three years by awarding the Fund a coveted five-star rating (Morningstar's highest) and has placed the Fund in the top 1% of performance in its category. We will work hard to stay there.

On the new investment front, please note WilTel. In recent years, the company spent roughly \$8 billion laying optic fibers with all the trimmings just in time to file Chapter 11 in April of 2002. Our interest was piqued when Leucadia National agreed to purchase 44% of the company as part of an overall plan of reorganization. After review of WilTel's plan of reorganization, the Fund purchased busted senior bonds that have since converted into equity of this newly reorganized company.

While our charter has always contemplated the use of a variety of value investing strategies, buying senior securities of bankrupt companies is new to the Fund. And while we frequently examine stressed industries, we rarely buy companies in new or rapidly evolving industries – even those making money. However, our downside risk in WilTel appears modest given the price paid, realistic cost saves, and WilTel's unique long-term agreements.

In our letters, we try to inform you about material issues that may bear on a decision to own shares in the Fund. We understand that some shareholders might appreciate a lengthier discussion of each security in the Fund's portfolio. However, the investment business is highly competitive and good ideas are rare. Keeping some of our thinking close to the vest is intended to benefit the Fund.

Three years of significant market declines following a mania created the environment allowing us to invest in WilTel. Additional distress and further investor capitulation will lead to other investments. We enter 2003 with plenty of cash and the patience to wait for compelling opportunities.

Lastly, we regret to inform you of the untimely death of our former colleague, Peter Russ. "Tony" was a keen analyst and friend to all who knew him – he will be missed.

All of us at Fairholme Capital Management wish you and yours a healthy, happy, and prosperous New Year.

Sincerely,



Bruce R. Berkowitz



Lawrence S. Pitkowsky



Keith D. Trauner