

# THE FAIRHOLME FUND

## LETTER TO SHAREHOLDERS FOR THE SIX MONTHS ENDED MAY 31, 2004

July 7, 2004

To Our Fellow Shareholders:

Below is a comparison of the Fund's performance and that of the Standard & Poor's 500 Index (both with dividends reinvested) for the six months ended May 31, 2004 and since inception, from December 29, 1999 to May 31, 2004:

	<b>6 Months Ended May 31, 2004</b>	<b>Since Inception</b>
<b>The Fairholme Fund</b>	<b>+ 9.2%</b>	<b>+ 104.5%</b>
<b>S&amp;P 500 Index</b>	<b>+ 6.8%</b>	<b>- 18.2%</b>

Over the Fund's 4.5 year life, our total return of 104.5% outperformed the Index by 122.7 percentage points while we tried to maintain Rule #1: Don't lose.

At May 31<sup>st</sup>, the Fund's cash and U.S. Treasury Bills totaled roughly 15% of assets. Combined with our portfolio concentration in companies generating and holding cash above what is needed, we are prepared for the big risk, and perhaps bigger opportunities, that will accompany higher interest rates.

The Fund now has a large exposure to the still depressed, yet vital, telecom services industry by following our purchase of Worldcom bonds last year with equity purchases of the successor, MCI. The reorganized company, with new management, new directors, and a strong balance sheet, has valuable assets - evidenced by the billions of cash generated during the company's Chapter 11 rehabilitation. Despite this, most seem to believe that long-distance pricing will fall to zero and that MCI isn't worth the cash the company has in the bank. We disagree. The combination of ever-increasing demand and the apparent cessation of failed price wars suggest to us that price declines are slowing, and, that with realistic efficiencies, MCI can prosper.

Property/casualty insurance remains our largest and most profitable concentration. Pricing remains rational and higher interest rates should lead to higher earnings. Berkshire Hathaway's insurance divisions are performing and Mr. Buffett is holding much cash and short-term bonds ready for the right opportunity – including higher rates. The same holds true for all of our other insurance operations at Alleghany, Leucadia, Markel, Mercury General, and White Mountains.

On a corporate governance note, Bruce Berkowitz was recently appointed to the Board of White Mountains Insurance Group, Ltd. (“WTM”). The Fund will be limited in its ability to transact in WTM securities as long as Bruce remains a director. Given our positive long-term outlook, we do not believe that restrictions on the Fund's ability to transact in WTM will have a negative impact over the long-term. To the contrary, insights gained from the talent at WTM should only improve our understanding of current and prospective investments.

Please visit [www.fairholmefunds.com](http://www.fairholmefunds.com) for further information about the Fund, including past reports and letters to shareholders.

All of us at Fairholme Capital Management look forward to the future and thank you for your support.



Bruce Berkowitz



Larry Pitkowsky



Keith Trauner