

FAIRHOLME FUNDS, INC.

PORTFOLIO MANAGER'S REPORT For the Year Ended December 31, 2010

This 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 are as of the latest public filing of the Fairholme Funds, Inc.'s (the "Funds" or "Fairholme") holdings at the time of publication.

Mutual fund investing involves risks including loss of principal. Performance information quoted herein represents past performance and is not a guarantee of future results. The investment returns and principal values of investments in the Funds will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than the performance information quoted within. The Fairholme Fund imposes a 2.00% redemption fee on shares held less than 60 days. Performance data does not reflect the redemption fee, which if imposed, would reduce returns. Any questions you have regarding the latest month-end performance can be obtained by calling Shareholder services at 1-866-202-2263. Additional information regarding the risks of investing in the Funds may be found in the Funds' current Prospectus. The S&P 500 Index is a widely recognized, unmanaged index of 500 of the largest companies in the United States as measured by market capitalization. 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. Investors cannot invest directly in an index. Please refer to the back cover of this document for additional important disclosures.

January 6, 2011

To the Shareholders and Directors of Fairholme Funds, Inc.:

In 2010, The Fairholme Fund earned 25.5% versus a gain of 15.1% for the S&P 500 Index ("S&P 500"). Since inception on December 29, 1999 and through December 31, 2010, The Fairholme Fund earned 342.9% versus a 5.0% gain for the S&P 500. A \$1 million investment in The Fairholme Fund when it started on December 29, 1999 was worth \$4,428,831 at December 31, 2010 compared to \$1,050,117 for a like investment in the S&P 500. The Income Fund earned 11.2% in its first year of life while the Barclays Capital U.S. Aggregate Bond Index ("Barclays Bond Index") earned 6.5%.

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PORTFOLIO MANAGER'S REPORT (Continued) For the Year Ended December 31, 2010

Below is a comparison of the Funds' unaudited performance (after expenses) with that of the S&P 500 (before expenses) and the Barclays Bond Index (before expenses), both with dividends and distributions reinvested, for the period ending December 31, 2010.

Fairholme Fund Performance to 12/31/2010	Six Months	One Year	Five Years	Ten Years	Since Inception 12/29/1999
Cumulative:					
Fairholme Fund	24.60%	25.47%	60.80%	196.02%	342.88%
S&P 500 Index	23.27%	15.06%	11.99%	15.07%	5.01%
Annualized:					
Fairholme Fund		25.47%	9.97%	11.46%	14.47%
S&P 500 Index		15.06%	2.29%	1.41%	0.45%

At November 30, 2010, the Fairholme Fund's Expense Ratio is 1.00%.

In the Funds' current prospectus dated March 30, 2010, the Fairholme Fund's Expense Ratio is 1.01%, which includes acquired fund fees of 0.01%. Acquired fund fees and expenses are those expenses incurred indirectly by the Fund as a result of investments in shares of one or more investment companies, including, but not limited to, money market funds.

Income Fund Performance to 12/31/2010	Six Months	Since Inception 12/31/2009
Cumulative:		
Income Fund	7.50%	11.16%
Barclays Capital U.S. Aggregate Bond Index	1.15%	6.54%

At November 30, 2010, the Income Fund's Gross Expense Ratio is 1.00%, and the Net Expense Ratio is 0.50%.

In the Funds' current Prospectus dated March 30, 2010, the Income Fund's Gross Expense Ratio is 1.00% and Net Expense Ratio is 0.50%. The Manager has contractually agreed to waive a portion of its management fees and/or pay the Income Fund's expenses (excluding taxes, interest, brokerage commissions, acquired fund fees and expenses, expenses incurred in connection with any merger or reorganization and extraordinary expenses such as litigation) in order to limit the net expenses of the Income Fund to 0.50% of the Income Fund's daily average net assets. The fee waiver/expense limitation became effective on December 31, 2009 and shall remain in effect for at least one year after the effective date of the current Prospectus.

The Fairholme Allocation Fund (NASDAQ: FAAFV) commenced operations on December 31, 2010 and opened to new investors on January 3, 2011.

Over the past few years, Fairholme's performance is due in large part to thousands of patriots in civil service who rescued the global financial system with much intelligence

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PORTFOLIO MANAGER'S REPORT (Continued)
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and hard work, demonstrating government at its best during a time of national crisis. On behalf of nearly 500,000 shareholders and clients, Semper Fi.

Charlie Fernandez and I remain grateful for the many professionals that directly and indirectly worked for our shareholders, with special thanks to the U.S. Treasury for equitable treatment at AIG, to Goldman Sachs for outstanding advice in Asia and to Brookfield Asset Management and Pershing Square for all stakeholders fully recovering in the restructure of General Growth Properties.

Government is doing its job. We'll continue to do ours, looking forward to further potential recovery at AIG, MBIA and others, while helping to remove the financial roadblocks to our country's economic growth.



Bruce R. Berkowitz
Managing Member
Fairholme Capital Management, L.L.C.