Mutual fund investing involves risks, including loss of principal. The chart below covers the period from inception of The Fairholme Fund (December 29, 1999) to December 31, 2012. Past performance information to December 31, 2012, quoted below is unaudited and 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 higher or lower than the performance information quoted below. Performance figures assume reinvestment of dividends and capital gains, but do not reflect a $2.00 \%$ redemption fee on shares redeemed within 60 days of purchase. Any questions you may have, including most recent month-end performance, can be answered by calling Shareholder Services at 1.866 .202 .2263 . 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. Given the wide scope of securities held by the S\&P 500, it should be inherently less volatile. The Fairholme Fund's performance may differ markedly from the performance of the S\&P 500 in either up or down market trends. The performance of the S\&P 500 is shown with all dividends reinvested into the index and does not reflect any reduction in performance for the effects of transaction costs or management fees. Investors cannot invest directly in an index. As reflected in its current prospectus dated March 29, 2012, The Fairholme Fund's Expense Ratio is $1.02 \%$, which includes acquired fund fees and expenses of $0.02 \%$. Acquired fund fees and expenses are those expenses incurred indirectly by The Fairholme Fund as a result of investments in securities issued by one or more investment companies, including, but not limited to, money market funds.

January 29, 2013
To the Shareholders and the Directors of The Fairholme Fund:
The Fairholme Fund (the "Fund") gained $35.81 \%$ versus $16.00 \%$ for the S\&P 500 Index (the "S\&P 500") in 2012. The following table compares the Fund's performance (after expenses) with that of the S\&P 500 with dividends and distributions reinvested for the period ended December 31, 2012:

|  |  |  | Cive | Ten |
| :--- | :---: | :---: | :---: | :---: | | Since |
| :---: |
| Inception |
| $(12 / 29 / 1999)$ |

A $\$ 10.00$ investment in the Fund at its inception has grown to $\$ 40.65$ (after expenses and assuming reinvestment of distributions) compared to $\$ 12.44$ for the S\&P 500. The difference between those returns on a $\$ 10.00$ investment, more than anything, demonstrates how the Fund has outperformed the market (as represented by the S\&P 500) over the long run. This difference is graphed below.


The Fund's average rolling 5 -year return was $71.22 \%$ versus $16.01 \%$ for the S\&P 500 . The Fund has outperformed the S\&P 500 in 94 of 975 -year periods, calculated after each month end. The Fund's worst 5 -year period return was ( 6.89 )\% versus ( 29.05 )\% for the S\&P 500 . In its best 5 -year period, the Fund's return was $163.08 \%$ versus the S\&P 500's best return of $105.13 \%$.

|  | Fund's Rolling 5-Year Period Return* |  |  |
| :--- | ---: | ---: | ---: |
|  | FAIRX |  | Relative |
| Best | $+163.08 \%$ | $+105.13 \%$ | Advantage |
| Worst | $(3 / 2000-2 / 2005)$ | $(10 / 2002-9 / 2007)$ | $+57.95 \%$ |
|  | $(6.89) \%$ | $(29.05) \%$ | $+22.16 \%$ |
| Average | $(1 / 2007-12 / 2011)$ | $(3 / 2004-2 / 2009)$ |  |
|  | $+71.22 \%$ | $+16.01 \%$ | $+55.21 \%$ |

* Represents the percentage returns over a five-year rolling period (calculated after each month end) since inception through December 31, 2012.

To recite an old Merrill Lynch advertisement, "We're bullish on America." Our companies are capable of generating reasonable returns on equity and the companies sell for significantly less than our estimate of current equity values. In each case, earnings potential continues to be obfuscated by costs to fix past problems. Company equity values within the Fund were up $32 \%$ last year, but related market prices remain far below.

We had a great 2012, after a horrible 2011, and expect the Fund to reach new highs in the not too distant future. The U.S. is in its fourth year of recovery, housing prices are increasing but have yet to reach replacement values, unemployment is starting to decline, and interest rates remain at record lows. Our holdings are cheap relative to underlying equity values - as cheap as in the beginning of 2012. The Fund is highly focused on 5 companies representing nearly $80 \%$ of its net assets, with the knowledge that it is better to own more of your best ideas than your 10th best. Today, cash and equivalents stand at $\$ 1.49$ billion, about $19.7 \%$ of the Fund. Given current liquidity and the potential for performance dilution to shareholders, the Fund has determined to suspend the sale of shares to new investors after the last day of this February. The Fund will remain available for purchase to existing shareholders, may make exceptions to this suspension, and reserves the right to recommence sales to new investors in the future.

Fred Fraenkel and I now oversee risk analysis on a day-to-day basis utilizing a multi-path, independent process. For those who do not know Fred, we first worked together in 1990 at Lehman Brothers when he led 110 analysts around the globe to the \#1 rank* and where a younger portfolio manager used him to critique work on the resurgence of financials after the commercial real estate collapse of that time. Two decades later, it's déjà vu all over again.

Onwards and upwards,


Bruce R. Berkowitz
Managing Member
Fairholme Capital Management

[^0]
[^0]:    
    
     as of the latest public filing of The Fairholme Fund with respect to such holdings at the time of publication, unless specified.

