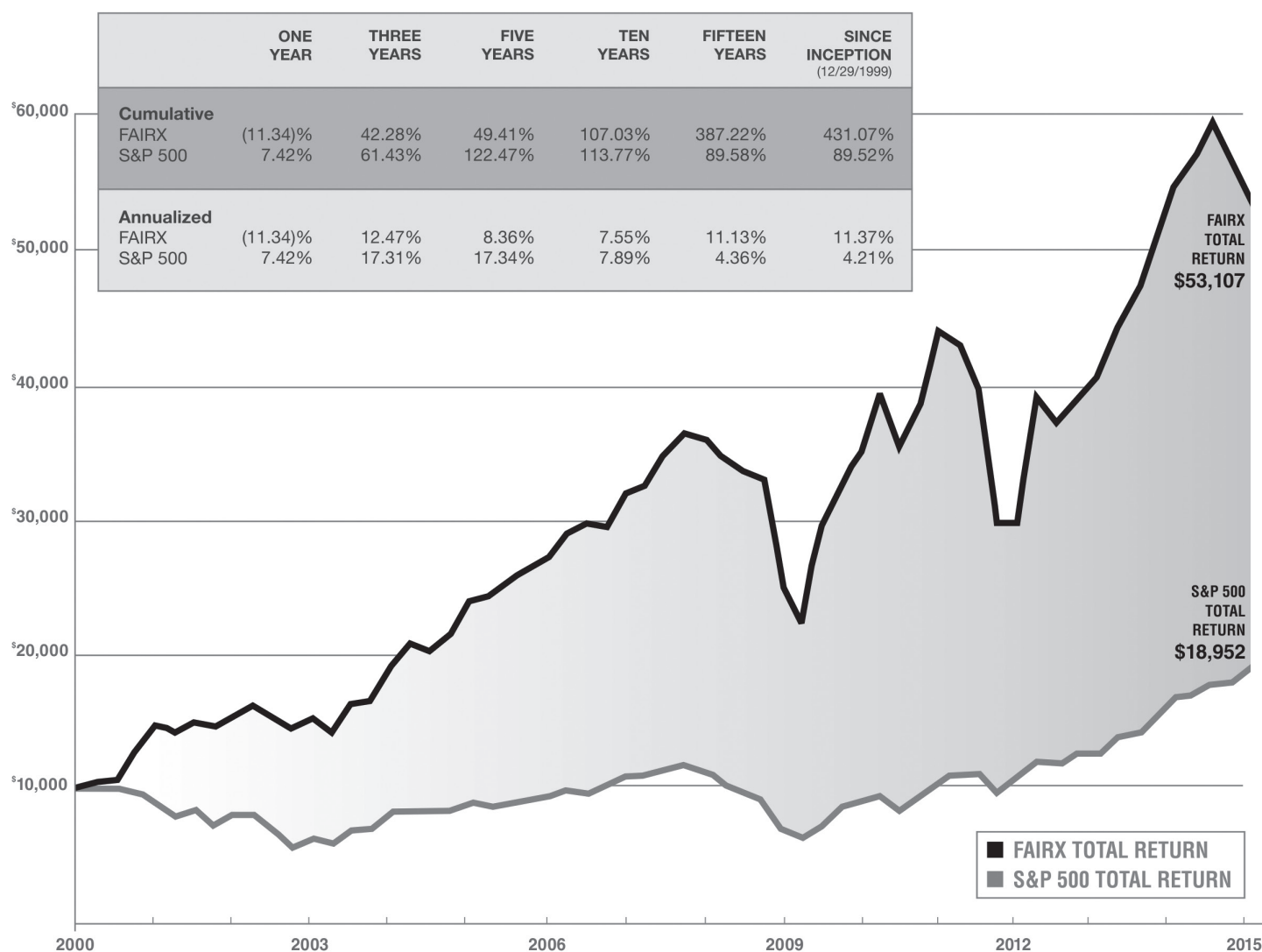


Mutual fund investing involves risks, including loss of principal. The chart below covers the period from inception of The Fairholme Fund (December 29, 1999) to June 30, 2015. Past performance information quoted below does not guarantee future results. The investment return and principal value of an 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 lower or higher than the performance information quoted below. Performance figures are after expenses and assume reinvestment of dividends and capital gains but do not reflect a 2.00% redemption fee on shares redeemed within 60 days of purchase. Most recent month-end performance and answers to any questions you may have can be obtained 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. The Fairholme Fund maintains a focused portfolio of investments in a limited number of issuers and does not seek to diversify its investments. This exposes The Fairholme Fund to the risk of unanticipated industry conditions and risks particular to a single company or the securities of a single company. The Fairholme Fund's performance may differ markedly from the performance of the S&P 500 Index in either up or down market trends. The performance of the S&P 500 Index is shown with all dividends reinvested and does not reflect any reduction in performance for the effects of transaction costs or management fees. Investors cannot invest directly in an index. The Fairholme Fund's total expense ratio reflected in its prospectus dated March 27, 2015, was 1.06%, which included acquired fund fees and expenses that are incurred indirectly by The Fairholme Fund as a result of investments in securities issued by one or more investment companies.

July 27, 2015

To the Shareholders and the Directors of The Fairholme Fund:

The Fairholme Fund (the "Fund" or "FAIRX") decreased 0.91% versus a 1.23% gain for the S&P 500 Index (the "S&P 500") for the six-month period that ended June 30, 2015. The following table compares the Fund's unaudited performance (after expenses) with that of the S&P 500, with dividends and distributions reinvested, for various periods ending June 30, 2015.



At June 30, 2015, the value of a \$10,000 investment in the Fund at its inception was worth \$53,107 (calculated by assuming reinvestment of distributions into additional Fund shares) compared to \$18,952 for the S&P 500. Of the \$53,107, the value of distributions reinvested was \$18,347.

The potential advantages of the Fund's long-term focused investment approach are most evident when evaluating performance over any consecutive 5-year period since the inception of FAIRX. The Fund has achieved 123 positive 5-year return periods and only 4 negative 5-year return periods, compared with 100 positive 5-year return periods and 27 negative 5-year return periods for the S&P 500. The Fund's average rolling 5-year return was 70.70% versus 35.09% for the S&P 500. The Fund has outperformed the S&P 500 in 96 of 127 5-year periods, calculated after each month's 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 185.26% versus the S&P 500's best return of 181.57%.

#### Rolling 5-Year-Period Returns\*

	FAIRX	S&P 500
<b>Best</b>	+185.26%	+181.57%
<b>Worst</b>	(6.89)%	(29.05)%
<b>Average</b>	+70.70%	+35.09%
<b>Percentage of Positive Periods</b>	96.85%	78.74%

AIG is our biggest winner (common and warrants comprise 29.6% of the Fund portfolio), as our remaining stake has almost tripled from the Fund's average purchase price. Book value grew 12% year-over-year, and the company's equity-to-assets now exceeds 20%. Fewer adverse developments from past business, reduced operating expenses, and common stock buybacks should allow the opportunity for double-digit growth to continue toward and potentially surpass book value per share.

The same should be true for Bank of America (20.6% of the Fund portfolio), which today has over \$250 billion in shareholder's equity – more than any other company in any industry in the United States. A focus on growing revenues while reducing operating costs (particularly litigation-related expenses) should result in rising profitability. With a Tier 1 capital ratio well above stringent regulatory requirements and "global excess liquidity sources" that would sustain operations for 40 months, Bank of America has regained the financial strength to support much higher earnings, yet its stock price also remains below book value.

The market price of Sears Holdings Corporation (7.1% of the Fund portfolio) reflects intense skepticism about the company's net assets and ability to transform its operating business. Since the Fund initiated its investment, Sears has distributed \$31.85 to its shareholders via spin-offs and other corporate actions. Most recently, Sears sold 235 properties, plus joint venture interests in 31 additional properties, for \$3.1 billion in cash proceeds. While the market is still digesting the facts associated with this recent separation transaction, our updated sum-of-the-parts valuation exceeds \$125 per share fully diluted, net of debt. We expect the company's focus on "profitability instead of revenues" to result in operational efficiencies, expense reductions, and gross margin improvement.

Recently, one CNBC television personality highlighted the real estate assets of Macy's and Ethan Allen and challenged his own "pedestrian" focus on retail sales performance: "Instead of looking at the earnings per share and the estimates . . . [look] at the more valuable real estate underneath . . . Never going to look at [them] the same way . . . !" It remains unclear why he and others are not willing to apply that same logic to Sears.

The Fund's latest investment is Seritage Growth Properties (1.4% of the Fund portfolio), a newly formed real estate investment trust that purchased the 266 properties from Sears and began trading this month. Seritage and its joint venture partners – GGP, Macerich, and Simon Property Group – intend to reconfigure or redevelop a substantial portion of the properties acquired in order to generate additional operating income and diversify the tenant mix. A recent analyst report noted that "the demographic profile of the [Seritage] owned portfolio is surprisingly good, with 10-mile density and incomes of 692k and \$77k, respectively, slightly better than the mall REIT portfolio averages of 680k and \$77k." We are bullish also based upon our independent assessment of real estate values, recent transaction data, and expected dividend increases as the company repositions properties to command higher rents from new tenants.

The St. Joe Company (6.7% of the Fund portfolio) recently announced that it received final approval from state and local agencies for its 110,000-acre Bay-Walton Sector Plan, with 170,000 residential units and more than 22 million square feet of retail, commercial, and industrial development. We believe that the company's nearly \$700 million in cash will enable it to implement the Sector Plan over time and simultaneously allocate the excess capital.

Today, shareholders of The Fairholme Fund collectively own \$3.4 billion liquidation value of Fannie Mae and Freddie Mac preferred stock. That means each shareholder effectively owns approximately \$25,000 (on average) of two of the most profitable franchises in America.

Yet for reasons that are not entirely understood, some in government apparently want their friends in the mortgage-industrial complex to take for free what you, the shareholders of these companies, paid for with cash. So we continue to search for the truth:

- Why did federal regulators design a financial support program for Fannie and Freddie on the basis of academic estimates of future performance rather than tried and true statutory accounting and claims-paying ability (which is the standard for all regulated mortgage insurers)?
- Why did federal regulators require Fannie and Freddie, while in conservatorship, to purchase \$40 billion per month in underperforming junk bonds from competitors?
- Why did federal regulators force Fannie and Freddie, while in conservatorship, to participate in Treasury's Home Affordable Modification Program (HAMP) and Home Affordable Refinance Program (HARP), which resulted in more than \$46 billion of losses that the companies would not have otherwise incurred?
- Why did mortgage-backed securities issued by Fannie and Freddie perform dramatically better than private label securities issued by big banks throughout the financial crisis?
- Why did federal regulators settle litigation cases initiated by Fannie and Freddie against major financial institutions for significantly less than what other similarly situated plaintiffs recovered?
- Why did federal regulators seize more than \$18 billion in litigation proceeds recovered by Fannie and Freddie to date?
- Why did federal regulators order Fannie and Freddie to delist their securities from the New York Stock Exchange in 2010?
- Why did federal regulators prohibit Fannie Mae from selling \$3 billion of Low Income Housing Tax Credits to third-party investors?
- Why were Fannie and Freddie, while in conservatorship, forced to divert billions of dollars in guaranty fees to Treasury to offset the cost of a payroll tax cut?
- Why did FHFA, as conservator, force Fannie and Freddie to gift all of their capital and all future earnings to Treasury in perpetuity?
- Why were Fannie and Freddie, while in conservatorship, forced to pay "voluntary" cash dividends to Treasury if funds were not available and the regulated entities were "not in capital compliance?"
- Why did FHFA force Fannie and Freddie, while in conservatorship, to issue debt in order to monetize their deferred tax assets and pay the proceeds to Treasury in 2013, particularly when FHFA had previously stated that deferred tax assets "[could] not be monetized?"
- Why did Fannie Mae CEO Tim Mayapoulos describe the Net Worth Sweep as a "positive change" with "a lot of good in it" in his August 2012 announcement to employees? Was he coerced by federal regulators?
- Why has the Securities and Exchange Commission permitted a single controlling shareholder (i.e., Treasury) and its affiliates to simultaneously act as director, regulator, conservator, supervisor, contingent capital provider, and preferred stock investor of two publicly traded companies?
- Why do some Treasury officials question the sustainability of Fannie and Freddie's earnings power in the years ahead, when Treasury's own 2014 Annual Report indicates that the companies will be consistently profitable for each of the next 25 years?
- Were certain federal government employees who crafted the Net Worth Sweep acting at the behest of crony capitalists seeking to displace Fannie and Freddie?

As owners, we demand answers to these and many other questions. Administration officials and their beneficiaries respond with alternative narratives that are wholly unsupported by the facts. They delay discovery and judicial proceedings at every opportunity. They deliberately conceal and withhold pertinent information. They conduct the business of government with little regard for the law.

In the Court of Federal Claims, the Federal Housing Finance Agency and United States Treasury produced "final" privilege logs listing 11,292 relevant documents (perhaps 100,000 pages of information) that they will not release – not to the public, not to the Fund's lawyers under a protective seal, not even to the Courts. The administration's sweeping effort to veil their conduct in secrecy has not gone unnoticed; *The New York Times* recently filed motions before the Court of Federal Claims requesting that various documents, which "have been improperly designated as Protected Information and kept confidential" by the government, be released to the public. In its motions, the *Times* noted that:

The courts have repeatedly recognized that disclosure of discovery is particularly appropriate when a lawsuit sheds light on the performance of governmental agencies and entities – which is precisely the case here . . . The public's interest in the underlying facts of this case is undeniable . . . The case directly addresses how the Government is going about recouping public funds used in the bailout and whether other investors are being treated lawfully. The Government should not be able to hide from the public – voters and taxpayers – the facts that were central to the decisions that the Government made as part of the far-reaching effort to safeguard the U.S. economy. To the contrary, access to the evidence will enable the public to understand more fully the decisions the Government has made in the public's name and to assess the wisdom and effect of those decisions . . . [The defendants'] disregard for the public interest is sadly of a piece with the Government's decision to make the depositions confidential in the first place. There is no reason that citizens should be denied the ability to effectively monitor this important lawsuit as it unfolds.

In the U.S. Court of Appeals (D.C. Circuit), the Fund's recently filed opening brief explains why the unprecedented and illegal 2012 Net Worth Sweep is antithetical to the fiduciary duties Congress imposed on FHFA as conservator of Fannie Mae and Freddie Mac – and should be vacated. The well-established duties of a conservator prohibit FHFA from running a ward for the government's exclusive enrichment, at the expense of all other interested parties and completely shielded from judicial review. Common sense dictates that a conservator conserves. In imposing the Net Worth Sweep, the FHFA, as conservator, unlawfully acts as an "anti-conservator." Eight briefs from various *amicus curiae* ("friends of the court") support the Fund's case. Here are a few highlights:

- Myron Steele, the former Chief Justice of the Delaware Supreme Court, persuasively argues that the Net Worth Sweep is "unenforceable and void *ab initio* under Section 151 of the Delaware General Corporation Law ("DGCL"). Preferred stock of a Delaware corporation cannot be given a cumulative dividend right equal to all the net worth of the corporation in perpetuity. The Net Worth Sweep is a flatly illegal term for any preferred stock instrument, whether or not held by the federal government . . . Preferred stockholders cannot have a perpetual claim on all the residual earnings of the Companies to the exclusion of common stockholders under Delaware law . . . Because the Net Worth Sweep diverts, in perpetuity, all of the net worth of the Companies (assets minus liabilities) to Treasury, it neither is paid at a 'rate' nor is it payable 'in preference to' or 'in relation to' the dividends payable to other classes or series of stock."
- Thomas Vartanian, a former bank regulatory General Counsel for the federal government, emphasizes that "as a purported method of financing the operations of the companies, the net worth sweep bears no resemblance to any prior financing arrangement ever entered into by the FDIC as conservator. [T]he common and well-understood function of an FDIC conservator is to place the regulated entity into a sound and solvent condition, and to preserve and conserve its assets for the eventual benefit of all shareholders and creditors, so that the entity can be returned to the control of its board of directors and shareholders . . . not an evasion of statutory duties and an end-run around a legal capital structure."
- Michael Krimminger, the former Deputy to the Chairman and General Counsel of the Federal Deposit Insurance Corporation, cogently articulates that, "Nothing in HERA authorizes the *de facto* nationalization of the Companies, such as occurred here, under the guise of a conservatorship. FHFA acted outside its authority as a conservator because it affirmatively acted to strip, rather than 'preserve and conserve,' the assets of the Companies and to bar any prospect that the Companies could return to a 'sound and solvent' condition."
- Timothy Howard, the former Chief Financial Officer for Fannie Mae, explains that "unlike the rescues of various commercial and investment banks at around the same time, Treasury directed FHFA to place Fannie and Freddie into conservatorship not in response to any imminent threat of failure, but rather for policy reasons and over the objections of Fannie's and Freddie's boards. Once in conservatorship, the Companies' managements had no role in negotiating the terms on which they would be offered assistance; Treasury and FHFA set these terms unilaterally. Treasury and FHFA [had] an extremely strong incentive to make accounting choices for the Companies that accelerated or exaggerated their expenses and greatly increased their losses, in order to create a large and permanent flow of revenue to Treasury . . . Treasury's effective nationalization of Fannie and Freddie was a policy decision, and the compensation Treasury granted itself upon taking over Fannie and Freddie was grossly disproportionate to the true economic risk it faced, both at the time and subsequently."
- A brief on behalf of the National Black Chamber of Commerce makes clear that the Net Worth Sweep forces Fannie and Freddie "to operate on the edge of insolvency – even though they would otherwise post billions of dollars in profits annually – until they are subsumed by the federal government . . . Fannie Mae and Freddie Mac play a vital role in minority communities by expanding access to credit and ensuring affordable housing. If allowed to stand, the Government's 'Net Worth Sweep' and winding down of Fannie and Freddie will damage those communities by drying up credit and denying African-Americans and other minorities the opportunity – the dream – of homeownership."

While common sense and the law are clearly on the Fund's side, critics continue to obfuscate the facts. Freddie Mac CEO Donald Layton noted recently that the company "might actually begin to do things that would be GAAP-oriented rather than economically oriented." This is a stunning admission that defies all logic, except in this unprecedented scenario whereby the company's assets are drained *by its regulators*. The implications are clear: Fannie Mae and Freddie Mac are purposely being rendered less safe and less sound each quarter – in direct contravention to the conservator's explicit mandate. Some may think that the regulators are simply suffering from cognitive dissonance given their feverish push for higher capital standards embodied in the Dodd-Frank Act, but there are clear indications of more disturbing elements at work – including greed, spite, and ulterior political motives. Thankfully, our constitutional system includes an independent judiciary.

Despite the progress that the Fund's portfolio companies have made, price performance has been weak and the gulf between our estimates of intrinsic values and market prices has widened in recent months. History teaches us time and time again that investment prices can experience periods of underperformance before becoming "overnight successes." Unfortunately, we are not proven market timers. Fortunately, we have high confidence in our company-specific analyses and ample liquidity (cash and cash equivalents comprise 14.3% of the Fund portfolio), and we recognize Mr. Market's propensity for sudden mood swings.

Onward and upward,



Bruce R. Berkowitz  
Chief Investment Officer  
Fairholme Capital Management

\* Represents the cumulative percentage total returns over a five-year rolling period (calculated after each month's end) since inception through June 30, 2015. Monthly rolling 5-year performance is a period of 60 consecutive months determined on a rolling basis, with a new 60-month period beginning on the first day of each calendar month since the inception of the Fund.

For a copy of the top holdings for The Fairholme Fund, please [click here](#). Portfolio holdings are subject to risk and may change at any time. Investors should consider the investment objectives, risks, charges, and expenses of the Fund carefully before investing. The Fund's prospectus contains this and other information about the Fund. To obtain a copy of the Fund's prospectus, please visit [www.fairholmefunds.com](http://www.fairholmefunds.com) or call 1-866-202-2263. Please read the prospectus carefully before investing. The Portfolio Manager's Report is not part of The Fairholme Fund's Semi-Annual Report due to forward-looking statements that, by their nature, cannot be attested to, as required by regulation. The Portfolio Manager's Report is based on calendar-year performance. A more formal Management Discussion and Analysis is included in the Semi-Annual Report. Opinions of the Portfolio Manager are intended as such, and not as statements of fact requiring attestation.

Fairholme Distributors, LLC (07/15)