The option's cost against the underlying's

> **OPTION VERSUS UNDERLYING COST**
>
> The honest comparison the options track owes: expressing a view through an option costs the premium, the spread, the commission and the decay carry; expressing the same view in the underlying costs the underlying's spread and commission and no carry. The option buys limited risk and leverage; the underlying pays no decay. Which is cheaper depends on the view - and a directional view with no timing edge often belongs in the underlying, not the option.

The options track assumes the equities track, and this lesson uses it: for many views, the underlying is an alternative to the option, and the honest question is which expresses the view more cheaply. The answer is not always the option.

The two cost structures

The option: premium (with its time value), spread (often wide), commission (per contract), and the decay carry (accelerating) - bought in exchange for limited risk and leverage.The underlying: the equities track's all-in cost - spread and commission, and no carry for a cash position; the view expressed directly, with symmetric risk and no leverage but no decay either.The trade-off: the option's limited risk and leverage against its decay and wider frictions - a real trade-off whose answer depends on the view's shape, not a default in either direction.

When each is cheaper

A view with precise timing and a need for limited risk or leverage can justify the option's carry - the decay is paid for a reason. A directional view with no timing edge, held for an uncertain period, pays heavy decay for leverage it may not need, and often expresses more cheaply in the underlying - which carries no decay and lets the view take its time. The most common retail error the comparison exposes: buying options to express a plain directional view that the underlying would have held more cheaply, paying decay and wide spreads for leverage that then works against the mis-timed view. The option is not the default way to express a view; it is one way, with a cost structure that suits some views and penalises others.

The comparison as discipline

Before expressing a view through an option, the disciplined reader compares: what does this cost as an option, all-in with decay, against what it costs in the underlying - and does the option's limited risk and leverage justify the difference? Sometimes yes, often no, and the comparison is the honest gate module 6 builds into the strategy verdict. Options are a powerful instrument for views the underlying cannot cheaply express - defined-risk, leveraged, volatility-based, precisely-timed views - and an expensive instrument for the plain directional views the underlying holds better. Knowing which is which, by costing both, is the options cost module's practical close.

Check your understanding

1. What does the option's cost structure include that the underlying's does not?

a. A wider spread only

b. The decay carry: an option bleeds time value continuously, where a cash position in the underlying carries no such cost - the option's carry is the difference

c. Commission

Answer: b. Both pay spread and commission; only the option pays decay. The option buys limited risk and leverage in exchange for the carry the underlying does not pay.

2. What view often belongs in the underlying, not the option?

a. A precisely-timed leveraged view

b. A directional view with no timing edge, held for an uncertain period - it pays heavy decay for leverage it may not need, and the underlying carries no decay

c. A defined-risk volatility view

Answer: b. The common retail error: buying options for a plain directional view the underlying would hold more cheaply. The option is one way to express a view, not the default.