

The bid-ask reality

OPTION SPREADS

Options spreads are wider and more variable than the underlying's: each cell in the chain has its own bid-ask, tight on liquid at-the-money options and wide on illiquid far strikes and distant expiries, and crossing it costs the gap times the contract multiplier on entry and exit. The spread is a real, often large cost that varies enormously across the chain - and the illiquid corners, where the spread is widest, are where retail most often trades.

Every cell in the chain has a bid and an ask, and the gap between them is a cost the options track must price - because options spreads are wider than shares', vary wildly across the chain, and are widest exactly where inexperienced traders wander.

Why options spreads are wide and variable

Liquidity varies by cell: a liquid at-the-money option on a major underlying has a tight spread; a far out-of-the-money option or a distant expiry may trade rarely, with a wide spread - the same chain holds both, cell by cell. The multiplier magnifies it: the spread is per share, times the contract multiplier - a spread that looks small per share is a real cash cost per contract, on both legs. Complex positions multiply legs: a position built from several options pays the spread on each leg (module 5's structures) - so a multi-leg position's total spread cost is the sum, and it compounds.

Where the spread bites hardest

The chain's wide-spread corners are exactly where retail is drawn: the cheap far-out-of-the-money options (the lottery tickets of module 1) are often the most illiquid, so the buyer pays a wide spread to enter a low-probability bet and another to exit - the spread eating a large fraction of an already-unlikely position. And the distant expiries, and the options on smaller underlyings, carry the same penalty. The reader who trades the liquid at-the-money options of major underlyings meets tight spreads; the one drawn to the cheap, far, exotic corners meets the widest, on the positions least able to afford them.

The costing discipline

The platform's spread discipline, on the option's own spread: cost the trade at the actual bid-ask of the specific cell, times the multiplier, on both legs, and for every leg of a multi-leg position - never at the mid, which is not where the trade fills. The all-in cost of an options position (module 3) assembles these, and the honest number is often a large fraction of the premium for illiquid options. Reading the chain includes reading the spread of the exact cell being traded - because in options, the spread is not a footnote to the premium, it is a major part of the cost, and it is largest where the position can least bear it.

Check your understanding

1. Why are options spreads widest exactly where retail is drawn?

- a. Retail trades the most liquid options
- b. The cheap far-out-of-the-money options and distant expiries are often the most illiquid, so a low-probability bet pays a wide spread to enter and another to exit - the spread eating an unlikely position
- c. Exchanges widen spreads for retail

Answer: b. The lottery-ticket corners of the chain are the least liquid. The spread eats a large fraction of an already-unlikely position - widest where the position can least bear it.

2. How should an options trade be costed?

- a. At the mid-price
- b. At the actual bid-ask of the specific cell, times the multiplier, on both legs and every leg of a multi-leg position - never at the mid, which is not where it fills
- c. At the premium alone

Answer: b. The mid is not where the trade fills. The spread is a major part of the cost in options, per cell and per leg - the platform's spread discipline on the option's own spread.