Strohmeier Ulrich: Transaction Costs in Options Trading – The Impact of Spreads on Long Directional Strategies

In this paper, the impact of bid/ask spreads displayed in the central orderbooks of Dutch equity option markets on the returns of pre-defined long option strategies is analyzed. Following an overview of empirical research on the determinants of bid/ask spreads in equity option markets, the correlation of the spread levels of specific stock options on Eurex with potential explanatory variables is calculated. The reduction of returns of long option strategies induced by different levels of spreads is then examined in a simulation set-up using random stock price movements and simplified option quote engines.